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Supreme Court, U. S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1938.

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No. 487.

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

*Petitioner,*

v.

PENNSYLVANIA WATER & POWER COMPANY,

*Respondent.*

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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## BRIEF FOR RESPONDENT.

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## BRIEF FOR RESPONDENT.

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### OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 16-25) in this case is reported in 36 B. T. A. 467, and the opinion of the Circuit Court of Appeals (R. 45-47), in 98 Fed. (2d) 812.

Cases now before this Court involving substantially the same question are *Metropolitan Edison Company v. Con-*

*missioner of Internal Revenue*, 35 B. T. A. 1110, 98 Fed. (2d) 807, and *General Gas and Electric Corporation v. Commissioner of Internal Revenue*, 36 B. T. A. 1326, 98 Fed. (2d) 561.

## QUESTION PRESENTED.

Respondent, as successor to its wholly owned subsidiary, in making its income tax return for the year 1928, deducted as an expense the unamortized discount and expense applicable to bonds issued by the subsidiary and retired in that year by Respondent. In the prior year the subsidiary had transferred all its property and franchises to Respondent under the procedure prescribed by the Act of the Commonwealth of Pennsylvania of April 29, 1874, Section 23, as amended, commonly known as the "short form" Merger Act. The question presented is whether this transaction was a mere sale, as Petitioner asserts, or a merger, or a change in form only equivalent to a merger, as Respondent contends.

## STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved will be found in Appendices A-E, *infra*, pp. 57-73.

## STATEMENT OF CASE.

Respondent operates a hydro-electric power plant on the Susquehanna River at Holtwood, Pennsylvania (R. 28). In order to provide its customers with an adequate and continuous supply of electricity and to utilize varying river flow to the best advantage, it became necessary to provide an auxiliary power plant operated by steam (R. 29). Respondent, being advised by its counsel that it had no corporate powers to engage in the business of generating electricity by steam, caused Holtwood Power Company, hereinafter referred to as "Holtwood Company", to be incorporated to carry on this activity (R. 29).

Respondent at all times owned all the capital stock of the Holtwood Company (R. 29) and operated the steam plant as a department of its business at such times as conditions of river flow necessitated the utilization of an auxiliary supply of electric energy (R. 30). The steam plant was operated by Respondent under an agreement dated August 26, 1924 (R. 34-36) by which Respondent received the entire output of the steam plant and paid all expenses of Holtwood Company, including an amount "to provide for amortization of debt, discount and security issue expense".

After the incorporation of Holtwood Company, Respondent was advised by its counsel that the two companies could not consolidate or merge because Respondent had the power to supply water to the public, which power Holtwood Company did not possess (R. 31). On June 26, 1926, the Supreme Court of Pennsylvania, in the case of *York Haven Water & Power Company et al. v. Public Service Commission of Pennsylvania et al.*, 287 Pa. 241, 134 Atl. 419, decided, under similar facts, that such a merger or consolidation might be consummated, provided the power to supply water be legally discarded (R. 31).

Respondent, on October 4, 1927, surrendered its corporate power to store, transport and supply water, in the manner prescribed by the corporation law of Pennsylvania (R. 31).

On December 21, 1927, Holtwood Company transferred all its property and franchises to Respondent under the procedure prescribed by the Act of the Commonwealth of Pennsylvania of April 29, 1874, Section 23, as amended by the Act of April 17, 1876, Section 5 and the Act of June 2, 1915 (R. 31). The sole consideration for the transfer

was the surrender of Holtwood's capital stock to it and the assumption of the obligation of its outstanding bonds by Respondent (R. 31). As provided in the Act, Holtwood Company "ceased to exist", upon the consummation of the transaction. [The Act of 1874 with its amendments, Purdon's Pennsylvania Statutes annotated, Title 15, Secs. 262-266, 595 (the applicable sections of which are set out in Appendix B hereof) will hereinafter be referred to as the "Act of April 29, 1874, as amended."]

Holtwood Company had issued its 6% bonds at a discount of five points in order to provide part of the funds for constructing the steam plant (R. 30), which discount and the expense incident to issuing the bonds was being amortized for income tax purposes over the life of the bonds (R. 30-31). Holtwood Company, prior to the transfer of its property and franchises, had no income other than payments made by Respondent pursuant to the agreement dated August 26, 1924 (R. 34-36), which included an annual payment to cover the amortization of debt discount and expense. Each year from 1924 to 1927, inclusive, a consolidated income tax return was filed for Respondent and the Holtwood Company in which the amortization of debt discount and expense was accounted for as follows: Respondent deducted the payments on account of amortization of debt discount and expense from its gross income as ordinary and necessary business expenses (cost of power), and the Holtwood Company reported these payments as income, which were offset by its deductions on account of amortization of discount and expense (R. 30-31). As the bonds were still outstanding when the transaction above referred to was effected, a part of the discount and expense remained unamortized (R. 32).

On March 1, 1928, Respondent retired the Holtwood bonds before maturity at a premium of 7% pursuant to the provisions of the mortgage indenture securing the bonds (R. 32), the necessary funds being secured from the sale of Respondent's 4½% bonds (R. 20). In its income tax return for that year, Respondent claimed deductions for the unamortized discount and expense and the retirement premium (R. 32).

Petitioner disallowed the deductions (R. 10), and Respondent appealed to the Board of Tax Appeals, which, by its decision, allowed the deduction of the premium but denied the deduction of the unamortized discount and expense on the ground that the transaction was not a merger but simply a sale of Holtwood Company's property to Respondent. Respondent appealed to the Circuit Court of Appeals for the Third Circuit, which, by its decision, reversed the decision of the Board of Tax Appeals and allowed the deduction of unamortized discount and expense on the ground that the transaction was a merger.

## SUMMARY OF ARGUMENT.

Respondent relies upon the following propositions:

I. It is well established by the decisions of the courts and by regulations of the Treasury Department, promulgated in conformity therewith, that when bonds issued at a discount are retired for cash prior to maturity by the issuer, the entire amount of unamortized discount and expense is deductible for income tax purposes in the year of the retirement even though the funds for such retirement are derived from the proceeds of a subsequent bond issue.

II. The Board of Tax Appeals and the courts have uniformly held that a corporation succeeding through

merger or consolidation to the assets and liabilities of the corporation issuing the bonds at a discount is entitled to the same deductions on account of bond discount and expense as the issuer.

III. The transaction by which Respondent succeeded to the assets and liabilities of the Holtwood Company was a merger.

IV. The transaction in question involved a change in form only and therefore the deductions should be allowed irrespective of the technical nature of the transaction.

## ARGUMENT.

### I.

**IT IS WELL ESTABLISHED BY THE DECISIONS OF THE COURTS AND BY REGULATIONS OF THE TREASURY DEPARTMENT PROMULGATED IN CONFORMITY THEREWITH THAT WHEN BONDS ISSUED AT A DISCOUNT ARE RETIRED FOR CASH PRIOR TO MATURITY BY THE ISSUER, THE ENTIRE AMOUNT OF UNAMORTIZED DISCOUNT AND EXPENSE IS DEDUCTIBLE FOR INCOME TAX PURPOSES IN THE YEAR OF THE RETIREMENT EVEN THOUGH THE FUNDS FOR SUCH RETIREMENT ARE DERIVED FROM THE PROCEEDS OF A SUBSEQUENT BOND ISSUE.**

When long-term bonds are issued by a corporation they may be sold by it at par or face value, at a discount, or at a premium. The controlling factors in determining whether the bonds shall be sold at par, at a discount, or at a premium are (1) the market rate of interest as compared with the interest rate specified in the bonds, and (2) the time which will elapse before the bonds mature. If the interest rate specified in a long-term bond is less than the market rate, investors are unwilling to pay par for the bonds and they must be sold at a discount. Conversely, if the bond interest rate is more than the market rate, the bonds may be sold at more than par, i. e., at a premium.

If an issue of 6% $1,000 bonds, maturing in 30 years, is sold at 97, the true interest cost of the borrowed money is the 6% interest prescribed in the bonds plus the discount of three points. Because this is the fact it is the accepted practice, for accounting and income tax purposes, to amortize the discount by writing it off in equal installments over the life of the bonds in order that each year may show the accurate or real cost of carrying the bond issue. In the case illustrated the true annual interest on each bond is treated as being $61 or 6.1% of the par value of the bond, $60 being paid to the bondholder and $1 being the amortization write-off (or the annual accrual to enable the issuer to pay the discount at the maturity of the bonds). Both the 6% interest and the .1% amortization write-off are deductible as accrued expense in computing the corporation's annual income tax.

The above theory of the nature of bond discount and the treatment for income tax purposes was explained by the Board of Tax Appeals in *Chicago, Rock Island & Pacific Railway Co. v. Commissioner,* 13 B. T. A. 988, 1031, 1033, quoted with approval by the Circuit Court of Appeals for the Fourth Circuit in *Western Maryland Railway Co. v. Commissioner,* 33 Fed. (2d) 695, 697.

If the bonds are paid off prior to maturity, say at the end of 10 years, at which time discount of $10 per bond has been written off, then the remaining $20 of such discount, which has not been amortized, must be paid by the corporation from its surplus or other funds. This unamortized discount is deductible in its entirety by the corporation in computing its income tax for the year in which the bonds are retired.

*U. S. Internal Revenue Regulations No. 74,* Art. 68 (3), promulgated under the Revenue Act of 1928. (See Appendix A.)

Expenses incurred by the corporation in issuing the bonds are treated in the same manner as discount for income tax purposes if the books are kept upon the accrual basis. Paragraph 4 of the Statement of Evidence (R. 28) shows that Respondent's books are kept on that basis.

*Helvering v. Union Pac. Railroad Co.*, 293 U. S. 282 (1934).

At times the market rate of interest declines materially so that a corporation can borrow money at a lower rate of interest than that borne by its outstanding bonds. In such case the outstanding bonds may be refunded. The corporation issues new bonds at the lower interest rate and with the cash obtained therefrom retires the old bonds prior to maturity pursuant to an option usually contained in corporate bonds.

Petitioner formerly contended that when bonds were retired prior to maturity by the use of proceeds of a refunding bond issue, the unamortized discount and expense and any retirement premium applicable to the retired bonds were expenses of floating the new issue and should be amortized over the life of the new bonds. The Board of Tax Appeals and the courts uniformly held that in such cases the entire amount of unamortized discount and expense, together with retirement premium, is deductible in the year of the retirement.

*The East Ninth Euclid Co. v. Commissioner*, 26 B. T. A. 32 (1932) (Rehearing 27 B. T. A. 1289);

*San Joaquin Light and Power Corporation v. McLaughlin*, 65 Fed. (2d) 677 (1933) (C. C. A. 9);

*The National Tile Co. v. Commissioner*, 30 B. T. A. 32 (1934);

*Helvering v. California-Oregon Power Co.*, 75 Fed. (2d) 644 (1935) (C. A., D. C.).

Petitioner acquiesced in these decisions and on November 9, 1935 promulgated *Treasury Decision 4603* (Internal Revenue Cumulative Bulletin XIV-2, p. 58) (See Appendix A) notifying the "Collectors of Internal Revenue and Others Concerned" that—

> "In determining the deductions for income tax purposes of items in respect of the refunding of bonds, the following rules shall apply in the instances specified:
>
> "(a) In the case of a retirement of an issue of old bonds from the proceeds of the sale of new bonds any amount paid in excess of the face value of the old bonds, less any amount of premium received when issued and not already returned as income, and any unamortized discount and unamortized expense attributable to such bonds, is deductible in the taxable year of their retirement."

The holding of the above cases and *Treasury Decision 4603* was approved by this Court in *Great Western Power Company of California v. Commissioner of Internal Revenue*, 297 U. S. 543, 546 (1936) (Footnote 7).

Petitioner and Respondent therefore agreed before the Board of Tax Appeals and the Circuit Court of Appeals that in the case at bar the sole question to be determined was whether Respondent, *as successor to the Holtwood Company*, was entitled, in computing its income taxes for 1928, to deduct the unamortized discount and expense applicable to the Holtwood bonds which it retired prior to maturity in that year.

## II.

**THE BOARD OF TAX APPEALS AND THE COURTS HAVE UNIFORMLY HELD THAT A CORPORATION SUCCEEDING THROUGH MERGER OR CONSOLIDATION TO THE ASSETS AND LIABILITIES OF THE CORPORATION ISSUING THE BONDS AT A DISCOUNT IS ENTITLED TO THE SAME DEDUCTIONS ON ACCOUNT OF BOND DISCOUNT AND EXPENSE AS THE ISSUER.**

The question involved in the case at bar, viz., the right of a corporation succeeding to all the assets and liabilities of a predecessor to deduct discount and expense applicable to bonds issued by its predecessor, has been before the Board of Tax Appeals and the courts in the following cases:

*Western Maryland Ry. Co. v. Commissioner*, 33 Fed. (2d) 695 (1929);
*Turner-Farber-Love Co. v. Helvering*, 68 Fed. (2d) 416 (1933);
*New York Central Railroad Co. v. Commissioner*, 79 Fed. (2d) 247 (1935) (Cert. den. 296 U. S. 653);
*Illinois Power & Light Corp. v. Commissioner*, 33 B. T. A. 1189 (1936) (Modified, 36 B. T. A. 385);
*Coast Counties Gas & Electric Co. v. Commissioner*, 33 B. T. A. 1199 (1936);
*American Gas & Electric Co. v. Commissioner*, 85 Fed. (2d) 527 (1936);
*American Gas & Electric Co. v. United States*, 17 Fed. Sup. 151, 84 Ct. Cl. 92 (1936);
*The Connecticut Electric Service Co. v. Commissioner*, 35 B. T. A. 444 (1937).

The successor corporation was allowed to take deductions on account of amortization of bond discount and expense (or the unamortized discount and expense where the bonds were retired prior to maturity by the successor) in the *Western Maryland* case, the *New York Central* case,

the *Illinois Power & Light Corp.* case, and *The Connecticut Electric Service Co.* case, in all of which the taxpayer succeeded the issuing corporation through merger or consolidation. In the two *American Gas & Electric Co.* cases, the deductions were allowed where the issuing company was *merged* into the successor and disallowed where the issuing company *sold* its assets to the successor. In the other cases there was clearly a *sale* of assets and the deductions were disallowed.

The Court of Claims in denying the deduction in the *American Gas & Electric Co.* case on the ground that neither a merger nor consolidation had taken place said:

> "• • • the Securities Corporation acquired the assets of the Virginian Company by the payment of a definite consideration, and we think it is a fair presumption that the price so paid was adjusted to meet the fact that the corporation would have to pay the bonds in full."

That being so it would have been inequitable to permit the buying corporation to claim a deduction in its income tax return for the bond discount when an allowance had been made for it in the purchase price.

Respondent desires to point out that as there was no cash or anything of value paid by it to Holtwood Company, the consideration (the surrender of Holtwood Company's stock to it and the assumption of its liabilities) could not have been adjusted, i. e., reduced, because of the unamortized bond discount and expense.

Petitioner conceded before the Board of Tax Appeals and the Circuit Court of Appeals that if the transaction by which Respondent succeeded to the assets and liabilities of the Holtwood Company was in fact a "merger",

the deduction should be allowed, but Petitioner contended that the transaction was in effect a mere sale by Holtwood of its assets.

## III.

### THE TRANSACTION BY WHICH RESPONDENT SUCCEEDED TO THE ASSETS AND LIABILITIES OF THE HOLTWOOD COMPANY WAS A MERGER.

*A. Consolidation, Merger and Sale Distinguished.*

The one question in this case primarily involves the distinction between the concepts of *consolidation* and *merger*, on the one hand, and the concept of *sale* on the other. While the terms "consolidation," "merger," and "sale" have distinct and mutually exclusive meanings, legislatures in drafting statutes and courts in their opinions have not always observed the distinctions between them, with the result that the language of statutes and many court decisions tends to confusion unless the statutes and the decisions be carefully analyzed in view of technical definitions of the terms.

A "*consolidation*" is a combination of two or more corporations by which the property, rights, privileges and franchises of all the consolidating corporations are united in a single *new* corporation, the consolidating corporations losing their separate corporate identities.

15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7041, pages 6-8.

A "*merger*," while in substance a consolidation, differs therefrom in that it is the absorption of one or more corporations by another, the former ceasing to exist and the latter retaining its corporate identity with the added capital, franchises and powers of the merged corporation or corporations. "It is the uniting of two or more corpora-

tions by the transfer of property to one of them, which continues in existence, the others being merged therein."

15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7041, pages 7-8.

A "*sale*" is the transfer of property for a valuable consideration. "Where there is a mere sale or transfer of the assets to another corporation a new corporation is not created and the respective companies remain distinct legal entities."

15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7044, page 16.

The criterion between a consolidation or merger on one hand and a sale on the other is that in the former there is an amalgamation of interests, whereas in the latter there is a divorcement of the property from its owners for a fair consideration, the selling corporation not being merged with the corporation acquiring its property but remaining in existence with the power to resume business. As stated in *Cortland Specialty Co. et al. v. Commissioner of Internal Revenue*, 60 Fed. (2d) 937 (1932) (Cert. den., 288 U. S. 599):

> "• • • merger and consolidation are words indicating corporate readjustments of existing interests. They all differ fundamentally from a sale where the vendor corporation parts with its interest for cash and receives nothing more. • • • *A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporation alone survives.* A consolidation involves a dissolution of the companies consolidating and a transfer of corporate assets and franchises to a new company. • • • *A sale of the assets of one corporation to another for cash without*

*the retention of any interest by the seller in the purchaser is quite outside the objects of merger and consolidation statutes.''* (Italics added.)

### *B. The Act of April 29, 1874, as Amended, Provides for Merger.*

Petitioner contended before the Board of Tax Appeals and in the Circuit Court of Appeals that in Pennsylvania a "merger" must be effected under the Act of May 3, 1909, and that the Act of April 29, 1874, as amended, only defines the procedure for a "sale".

The Act of May 3, 1909 (the pertinent provisions of which are set out in Appendix C), although employing the terms "merger and consolidation", does not provide for a *merger* at all and only provides for a *consolidation*. This is apparent from the provisions of the Act. It provides that a joint agreement shall be entered into, setting forth the "name of the *new* corporation," • • • "the *first* directors and officers," • • • "the manner of *converting the capital stock of each of said corporations into the stock of the new corporation,*" and that "new letters patent" shall be issued thereon. It is clear, therefore, that, although the Act of 1909 uses the terms "merger and consolidation," it effects a combination of two or more corporations into a single *new corporation* for which new letters patent must be issued and the stock of which must be substituted for the stock of the old corporations. Since the Act provides for a *new corporation* in place of all the old corporations combining thereunder and does not provide for the *survival of one of the old corporations* with the added franchises, powers and property of the others, it is obvious that this is a *consolidation* statute and not a *merger* statute.

This fact was pointed out by E. Russell Shockley, Esq., Special Deputy Attorney General and draftsman of the Pennsylvania Corporation Act of 1933, in an annotation to Section 901, which appears on page 104 of *"Pennsylvania Corporation Laws of 1933"*:

> "As used in the Act of 1909, the words 'consolidate' and 'merge' were used synonymously, whereas such words, technically, have different meanings. In a merger, only one of the constituent corporations survives, whereas the others lose their identities; while in a consolidation all the constituent corporations lose their identities and a new corporation springs up in their place. This act, [referring to the 1933 Act] like the Uniform Act and the acts of the states above listed, makes a clear distinction between a merger and a consolidation."

The Act of April 29, 1874, as amended, definitely provides a procedure by which the property, rights and franchises of one corporation may be united with those of another, the latter continuing its existence while the former by operation of the statute *ceases to exist*. The pertinent provisions thereof are as follows:

> *"Section 23.* Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and *it shall be lawful for any corporation in the same manner to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the*

> *said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid:* Provided, That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date." (Italics added.)

A transaction, like that in the case at bar, under this statute meets all the requirements of a *merger* as above defined. See *supra, pp.* 12-13. This fact has long been recognized by the Bar and the Courts of Pennsylvania, and this Act has been even more frequently used to unify corporations than the Act of 1909.

Mr. Shockley, in the last two sentences of his "Comments" on Sec. 311 of the *"Pennsylvania Corporation Laws of 1933,"* page 39, says:

> "• • • This provision of the act provides a statutory procedure for the voluntary sale of the corporate property and assets, excluding its franchises, and makes no change in the existing case law. *It does not, however, authorize or have the effect of a merger similar to that formerly authorized by Section 23 of the Corporation Act of 1874 as amended."* (Italics added.)

The practice of employing the Act of April 29, 1874, as amended, to merge corporations became common as a re-

sult of the decision of the Supreme Court of Pennsylvania in *Bly v. White Deer Mountain Water Co.*, 197 Pa. 80 (1900). The Court held that certain utility corporations could carry on their business only in the town, borough, city or district in which they were located and not in territory adjacent thereto. The practical result of this decision was that it became necessary for some utility companies to form a different corporation in every municipal district where present or future operations might be contemplated. It was, however, uneconomical to construct a separate operating plant in each district for which a charter had been granted so the plan was evolved of unifying the corporations in order that the business could be carried on in substantially the same manner as if the charter of one corporation authorized it to operate in all the districts. The Legislature had prescribed two methods by which such unification might be effected: (1) merger under the Act of April 29, 1874, as amended, or (2) consolidation under the Act of 1909. As the effect of the Act of April 29, 1874, as amended, preserving the identity or existence of one corporation, offered certain obvious advantages over the creation of a *new* corporation under the Act of 1909, the former was largely employed and the two methods came to be distinguished by the respective descriptive, but untechnical, names of the "short form" and "long form" merger.

In *Pennsylvania Utilities Co. v. Public Service Commission*, 69 Pa. Superior Ct. Rep. 612 (1918), Judge Kephart, now Chief Judge of the Supreme Court of Pennsylvania, made the following statement, concerning the necessity of unifying the charters of such utility companies, in which he recognized the fact that a merger resulted under the Act of 1874, as amended (which he called

the "Purchase Act" of 1876, presumably because one of the steps in effecting the merger took the form of a sale):

> "The question presented by this and a number of other appeals now before the court is of considerable importance to utility companies in the Commonwealth. After the decision in the case of Bly v. White Deer Mt. Water Company, 197 Pa. 80, there was a great effort by certain utilities to secure charters for the municipal districts they deemed necessary to their present and future plan of development. These concerns found it impossible, because of the great economic waste, to construct separate operating plants in each of the districts for which charters were secured. The legislature had supplied a way by which the charters might be unified and very much the same result obtained as though a charter for more than one district had been permitted. The Purchase Act of 1876 was largely employed. See Hey v. Springfield Water Co., 207 Pa. 38; Commonwealth v. Lumber City Water Co., 225 Pa. 317; Greensburg Boro. v. Westmoreland Water Co., 240 Pa. 485; and a list of authorities there referred to. *As a legal consequence the purchase act differs but little from the merger act which is used to some extent to consolidate companies.* * * *" (Italics added.)

In *York Haven Water & Power Co. et al. v. Public Service Commission of Pennsylvania et al.*, 287 Pa. 241, 134 Atl. 419 (1926), the question before the Court concerned the right of an electric light, heat and power company to merge with a hydro-electric or water power company. The Court held that the merger could not be accomplished until the right of the hydro-electric company to furnish water to the public (which was not common to both companies) was legally discarded. In the course of the opinion, the Court, per Kephart, J., said:

"There are two forms of consolidation in Pennsylvania, a short and a long form merger. These are accomplished by the Act of 1876, as amended, and the Act of 1909. The Act of 1876, P. L. 33, as amended, provides that such sale may take place if the 'franchises are not inconsistent' with this act. And the merger Act of 1909, P. L. 408, permits consolidation between corporations 'transacting the same or similar lines of business.' * * *

"* * * *

"* * * *A sale or merger, under the Act of 1876, with its amendment, or the Act of 1909, which is practically the same,* cannot take place until the company legally discards the offending power. * * *" (Italics added.)

The Act of 1876 mentioned by the Court is the Act of 1874 as amended by the Act of April 17, 1876, Sec. 5 and the Act of June 2, 1915, under which the transaction in the case at bar was effected.

The Act of 1874, as amended, was the only law of Pennsylvania under which a merger could be effected prior to the enactment of the Pennsylvania Corporation Law of 1933, and it remains the only Act under which a merger of certain public utility corporations can now be effected inasmuch as the 1933 law does not apply to them. Article IX of the new law, entitled "Mergers and Consolidations," with this exception, repealed both the Act of 1874, as amended, and the Act of 1909 and made a clear distinction between mergers and consolidations. If the transaction in the case at bar had taken place under the Corporation Act of 1933, Article IX, the Petitioner would undoubtedly admit the correctness of Respondent's position. It is therefore pertinent to compare the procedure and effect of a merger under the 1933 Act (See Appendix D) with that under the Act of 1874, as amended:

| *Procedure and Effect of Merger Under Corporation Laws of 1933:* | *Procedure and Effect of "Short Form" Merger Under Act of April 29, 1874, as amended, as followed in the Case at Bar:* |
|---|---|
| 1. Directors of each corporation approve plan of merger (Sec. 902 A) and call meeting of Stockholders (Sec. 902 B). | 1. Directors of merging corporation authorize the merger and call meeting of stockholders (Sec. 19). Directors of surviving corporation approve merger under general law. |
| 2. Plan of merger submitted to and approved by stockholders of each corporation (Sec. 902 B-C). | 2. Plan submitted to stockholders of merging corporation and approved (Sec. 23 and 20-21). |
| 3. (Sec. 903) Each corporation executes Articles of Merger, containing the following:<br>(a) Name of surviving corporation.<br>(b) Total vote of stockholders by which the plan was adopted.<br>(c) Any changes in charter of surviving corporation.<br>(d) Plan of merger. | 3. All property, rights and franchises of merging corporation transferred by deed to the surviving corporation (Sec. 23). |
| 4. Advertisement of intent to file Articles of Merger with Department of State (Sec. 904). | 4. Advertisement of object of meeting of stockholders (Sec. 19). |
| 5. Articles of Merger filed in Department of State and approved after all taxes have been paid (Sec. 905). | 5. Return of "election of the stockholders" (i. e., the vote on the plan) and return of transfer of property filed with the Secretary of the Commonwealth after all t[illegible]s have been paid (Sec. 22-23). |
| 6. Effect of Merger (Sec. 907):<br>(a) All corporations parties to the plan except the surviving corporation cease to exist.<br>(b) All property and franchises vest in the surviving corporation.<br>(c) Claims existing or actions or proceedings pending against the merging corporation may be prosecuted to judgment against either it or the surviving corporation. | 6. Effect of Merger:<br>(a) Corporation transferring property ceases to exist; corporation receiving property survives (Sec. 23).<br>(b) All property and franchises vest in surviving corporation (Sec. 23).<br>(c) Claims existing or actions or proceedings pending against the merging corporation may be prosecuted to judgment against either it or the surviving corporation. (*Merwine v. Mt. Pocono Lt. & Imp. Co.*, 304 Pa. 517). |

While the procedural steps under the two acts differ, in effecting a merger like the one in the case at bar, they are not essentially different, and the resultant effect is precisely the same—

(a) The corporation which transfers its property and franchises ceases to exist and the corporation acquiring the property and franchises survives;

(b) Claims existing or actions or proceedings pending against the merging corporation may be prosecuted to judgment against either it or the surviving corporation.

*C. Petitioner's Contentions.*

Notwithstanding the statements by the Supreme Court of Pennsylvania that a merger may be effected under the Act of April 29, 1874, as amended, Petitioner insists (Petitioner's Brief, p. 22) that such is not the case because

(a) The Act "in terms applies to sales and not to mergers and consolidations;"

(b) The Act "does not provide that the purchasing corporation shall assume the debts of the seller."

The early corporation laws of the various states, like that of Pennsylvania, were not drawn with the care as to detail which characterizes the more modern corporation laws, and inexact language was frequently used. In cases involving the transfer of the franchises and property of a corporation to another under such statutes the courts have looked at the nature of the transaction itself, rather than the phraseology of the statute, in determining whether the transaction was a sale or a consolidation or merger.

In *Chicago, Santa Fe and California Rwy. Co. v. Ashling*, 160 Ill. 373, 380, 381, 43 N. E. 373, 375 (1895), the Chicago and St. Louis Railway Co. transferred all its property and franchises by a deed of conveyance to the appellant. The question before the Court was whether this transaction, which was in form a sale, was not in fact a "consolidation." In holding that the transaction was a "consolidation" and that the defendant was liable for the torts of its predecessor from which it purported to "buy" assets, the Court said:

> "• • • It is true, that what was done must be considered in order to determine whether there was a consolidation or not; but we must look to the results accomplished, rather than to the means, steps or procedure by which those results have been attained.
>
> "• • • *There is no magic in words. Merely calling the transaction a purchase and sale would not prevent it from being a consolidation.* It cannot be supposed, from the nature of this transaction, that it was expected that the St. Louis company should continue its active corporate existence after divesting itself of all its property, corporate rights and franchises and stockholders." (Italics added.)

In *Continental Trust Co. v. Toledo, St. L. & K. C. R. Co.*, 82 Fed. 642, 652 (1897), Mr. Chief Justice Taft, then Circuit Judge, considered the effect of an Illinois statute which provided:

> "That all railroad companies now organized, or hereafter to be organized under the laws of this state, which now are or hereafter may be, in possession of and operating in connection with or extension of their own railway lines any other railroad or railroads in this state, or in any other state or states, or owning and operating a railroad which connects

at the boundary line of this state with a railroad in another state, *are hereby authorized and empowered to purchase and hold in fee simple* or otherwise and to use and enjoy, the railway property, corporate rights and franchises of the company or companies owning such other road or roads upon such terms and conditions as may be agreed upon between the directors and approved by the stockholders," etc. (Italics added.)

Concerning the effect of this statute, which is worded in terms of sale, the learned Judge said:

"Although this act uses the word 'purchase,' it plainly contemplates consolidation, and this is the holding in Illinois * * *"

In 8 *Thompson on Corporations,* 3rd Edition, Sec. 6012, page 66, the learned author says:

"* * * In a merger of two or more corporations, one of the merged corporations survives; that is, the merger consists in the uniting of two or more by the transfer of all the property to some one of the existing corporations, which continues its existence, while the others are swallowed up by or merged in the one that exists. And in this respect it differs from a consolidation, wherein * * * all the corporations terminate their existence and become parties to a new one. *The true test as to whether or not there has been a merger, is as to whether the existence of one of the corporations has been preserved and the other has ceased to exist.*" (Italics added.)

In Section 6019 at page 78 the author says:

"* * * But, as already noticed, and as judicially held, consolidation may be effected by the purchase of all the property and franchises of one corporation by another * * *."

In 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7044, pp. 16-17, the author says:

> "• • • if the coming together of two corporations under the authority of law be in fact consolidation • • • it is of no consequence by what name the act is characterized nor is it of any consequence by what steps the result has been effected, *and one of these steps may take the shape of bargain and sale.*" (Italics added.)

Petitioner says that the courts of Pennsylvania have also construed the Act of 1874 as authorizing *sales* (Petitioner's Brief, p. 30), citing:

*Koehler v. St. Mary's Brewing Co.*, 228 Pa. 648;
*Ringler v. Atlas Portland Cement Co.*, 301 Pa. 176;
*Carr v. Rochester Tumbler Co.*, 207 Pa. 392;
*Maxler v. Freeport Bank*, 275 Pa. 510;
*Greensburg Borough v. Westmoreland Water Co.*, 240 Pa. 481, 485-486;
*Buist's Estate*, 297 Pa. 537.

Respondent does not contend that every transaction carried out under the Act of April 29, 1874, as amended, is a merger. The Act has been recognized as authorizing both ordinary sales of property and mergers. No one would say, where one corporation, pursuant to the Act, purchases property and franchises of another *for a full cash consideration*, that the purchaser becomes liable for the obligations of the seller by operation of law, or that there is a *merger* of the corporations. In such a case there is no amalgamation of interests, no continuation of the interests of the owners of the selling corporation in the buying corporation as there must be in a merger. In such instances the old corporation and its

owners *divorce* themselves from the business. Examination of the above cases, cited by Petitioner, reveals that they have no application to the situation involved in the case at bar. In *Koehler v. St. Mary's Brewing Co.*, 228 Pa. 648, there was not a *merger* but an *ordinary sale* of property for which the proposed consideration was $250,000, payable in thirty year bonds of the transferee.

With the fact in mind that either a merger or an ordinary sale may be effected under the Act of April 29, 1874, as amended, the inapplicability of other cases cited by Petitioner (*Ringer v. Atlas Portland Cement Co.*, 301 Pa. 176, *Greensburg Borough v. Westmoreland Water Co.*, 240 Pa. 481, and *Maxler v. Freeport Bank*, 275 Pa. 510) is apparent. In all these cases bills for injunction had been filed by dissenting stockholders to restrain the transfer of the company's assets. In these cases the issue was the legality of the transaction irrespective of the question (which was not involved) whether it was a merger or an ordinary sale. Furthermore, in the *Ringler* case and the *Freeport Bank* case the transactions were not under the Act of April 29, 1874, as amended, which fact was specifically pointed out by the court in both cases. In the former the decision rested on the general power of a corporation flowing from ownership of property to dispose of it unless restrained by its charter or by statute, and in the latter the transaction was effected under a statute (Act of May 13, 1876) relating only to banks.

In *Carr v. Rochester Tumbler Co.*, 207 Pa. 392, cited in Petitioner's Brief, p. 30, plaintiff had attended a stockholders' meeting and voted in favor of the sale of the company's assets to National Glass Co. *for cash and*

*stock of the latter.* Plaintiff then sued for the value of his stock. It does not appear that the transaction was effected under the Act of April 29, 1874, as amended, for it is not mentioned in the opinion. The decision against the plaintiff rested on estoppel by reason of his vote and the nature of the transaction was not involved. Furthermore, relief to dissenting stockholders by payment of the value of their stock is not inconsistent with either merger or consolidation, such relief often being provided by statute.

Petitioner also relies on the case of *Buist's Estate*, 297 Pa. 537 (Petitioner's Brief, p. 30). In that case there was a merger of Philadelphia banking institutions under the National Banking Act. The Supreme Court of Pennsylvania has, both before and after the decision in *Buist's Estate*, indicated that said transactions under the Act of April 29, 1874, as amended, were mergers. Judge Kephart's statement in the opinion in *Buist's Estate* that the operation of the Act effects a sale therefore is nothing more than a recognition that ordinary sales as well as mergers can be accomplished under the Act.

Analysis of the facts in the case at bar reveals the following: (1) Holtwood Company was incorporated in order to comply with the corporation laws of Pennsylvania to carry on an activity necessary to Respondent's business in which the latter had no power to engage (R. 29); (2) Respondent owned all the capital stock of Holtwood Company (R. 29); (3) the steam plant of Holtwood Company was operated by Respondent's officers and employees simply as a department of Respondent (R. 29-30); (4) on December 21, 1927, after it was found that Holtwood Company could lawfully be merged into or consolidated with Respondent, a short form merger was

effected pursuant to the Act of April 29, 1874, as amended, by the transfer of all the property and franchises of Holtwood Company to Respondent and the surrender of all the capital stock of the former (R. 31); (5) pursuant to the provisions of the Act, Holtwood Company ceased to exist as a separate corporate entity (R. 31); (6) the interests of the owners of Holtwood Company and Respondent remained the same after the transaction as before, Respondent simply absorbing Holtwood Company and continuing to exist with the added property and franchises of the latter. The short form merger of Holtwood Company into Respondent therefore meets all the requirements of a true merger.

*D. Liability of Successor Corporation for Debts and Torts of Merged Corporation.*

The Circuit Court of Appeals for the Second Circuit, in the *General Gas & Electric Corporation* case now before this Court (98 Fed. (2d) 561), said:

> "* * * In American Gas & Elec. Co. v. Commissioner, 85 F. (2d) 527, this court stated as an essential of such a merger as would entitle the successor corporation to claim deductions of the unamortized bond discount and expense of the merged corporation, that the successor must by operation of law become responsible for the liabilities of the merged corporation. A provision imposing such liability is certainly customary in technical merger statutes; such liability is expressly provided in the 'long form merger' Act of 1909, as it is also in the Act of May 5, 1933. The absence of such a provision in the Act of 1874, and the construction placed upon that statute in Merwine v. Mt. Pocono Light & Imp. Co., 304 Pa. 517, seem to us fatal to the taxpayer's contentions. In that case the plaintiff, a creditor of the

> selling corporation, moved to substitute the purchasing corporation as a party defendant in an action pending against the seller. The denial of that motion, affirmed by the Supreme Court, shows that under the Act of 1874, the purchasing corporation does not succeed, simply by operation of law, to the liabilities of the seller. Accordingly, we think the case at bar is governed by our decision in American Gas & Elec. Co. v. Commissioner, supra."

It is true that the Act of 1874 does not contain a provision imposing liability on the successor corporation for the debts and torts of the merged corporation. But the absence of such a provision from early consolidation and merger statutes is not unusual. The question of liability of the successor corporation in such cases has been passed upon by this Court and the Courts of several of the states.

In *Mt. Pleasant v. Beckwith*, 100 U. S. 514, a town had issued bonds and later had been merged into other towns by an Act of the Legislature. A bond holder sued the successor towns on the bonds. The Act merging the towns made no provision for payment of the bonds. In holding that the successor was liable for the debt this Court said:

> "Speaking to the same point, the Supreme Court of Missouri held that where one corporation goes entirely out of existence by being annexed to or merged in another, if no arrangements are made respecting the property and liabilities of the corporation that ceases to exist, the subsisting corporation will be entitled to all the property and be answerable for all the liabilities. *Thompson v. Abbott*, 61 Mo., 176, 177.
>
> "Grant that, and it follows that when the corporation first named ceases to exist there is then no power

left to control in its behalf any of its funds, or to pay off any of its indebtedness. Its property passes into the hands of its successor, and when the benefits are taken the burdens are assumed, the rule being that the successor who takes the benefits must take the same *cum onere*, and that the successor town is thereby estopped to deny that she is liable to respond for the attendant burdens. * * *

"* * *

"Neither argument nor authority is necessary to prove that a State legislature cannot pass a valid law impairing the obligations of a contract, as that general proposition is universally admitted. Contracts under the Constitution are as sacred as the Constitution that protects them from infraction, and yet the defense in this case, if sustained, will establish the proposition that the effect of State legislation may be such as to deprive a party of all means of sustaining an action of any kind for their enforcement. * * *

"* * *

"When the appellant towns accepted the annexation, their authorities knew, or ought to have known, that the extinguished municipality owed debts, and that the Act effecting the annexation made no provision for their payment. They had no right to assume that the annulment of the charter of the old town would have the effect to discharge its indebtedness, or to impair the obligation of the contract held by its creditors to enforce the same against those holding the territory and jurisdiction by the authority from the legislature and the public property and the power of taxation previously held and enjoyed by the extinguished municipality.

"* * *

"Extensive powers in that regard are, doubtless, possessed by the legislature; but the Constitution provides that no State shall pass any 'law impairing

the obligation of contract,' from which it follows that the legislature, in the exercise of any such power, cannot pass any valid law impairing the right of existing creditors of the old municipality * * *"

In 1893, the Court of Appeals of Maryland, considering the effect of a consolidation under a general act of the legislature which made no provision with respect to the debts of the consolidating corporations (see Appendix E), in *Dodson v. Baltimore and Lehigh R. R. Co. et al.*, 77 Md. 489, held the successor corporation liable therefor, saying:

"* * * The legal consequences of this consolidation must depend on the Act of Assembly by which it was authorized. The Act of 1890, ch. 553, contains very few details; it enables two railroad companies, whose tracks form a continuous line, to consolidate with each other. It must be the result of this proceeding that the two original corporations cease to exist, and a third one comes into being, which comprehends both of them. It is composed of both; it is in effect both united into one. Nothing is destroyed by the consolidation; whatever appertained to either of the constituent bodies, now, in the same measure and under the same conditions, appertains to the composite body. It was the intention of the Legislature to enable the consolidating corporations to do more efficiently what they had the power to do before. It could not have been the purpose to deprive them of any rights, property or credits which they previously had; neither was it the purpose to relieve them from any responsibilities which they had incurred. The design was to gather into one all the concerns of each of them, and vest them in the corporation formed by their union.

"The new corporation thus created was in reality the embodiment under another name of the two formerly existing. They had been joined together in

every faculty and function, and molded into an indivisible unity, with none of their rights impaired, and none of their responsibilities abated. If this were not the result of the consolidation, very great inconvenience and injustice would arise. The Act of Assembly enables two corporations to consolidate upon such terms as may be agreed upon. This agreement refers to the adjustment of the interest of the stockholders, and the settlement of the terms on which they shall hold the stock of the new company, and to matters belonging to the organization of the new corporation and such like things. Whatever else it may be competent to determine by agreement, the combining companies could not, by any contract between themselves, conclude the rights of persons who had been injured by their *torts*. Their agreement to consolidate brings the new corporation into existence, and then its liabilities are determined by the just construction of the statute, which authorizes the consolidation. * * *"

In addition to the cases above cited, the courts of Indiana, Kansas, Mississippi, Missouri and Virginia have held that notwithstanding the absence of a statutory provision imposing liability on the successor corporation, it is liable on one of the two following theories:

(a) The debts and liabilities "become by implication the obligations of the new corporation." *Louisville, New Albany & Chicago Ry. Co. v. Boney*, 117 Ind. 501, 20 N. E. 432 (1889); *Berry v. Kansas City, Ft. Scott & Memphis R. R. Co.*, 52 Kans. 774, 775 (1894); *Thompson v. Abbott*, 61 Mo. 176 (1875); *Morrison v. American Snuff Co.*, 79 Miss. 330 (1901); *American Ry. Express Co. v. Downing*, 132 Va. 139, 111 S. E. 265 (1922). In the latter case the Court said:

"Many of the authorities, *in the absence of statute fixing the liability* (which is the situation touching

the case in judgment), regard the liabilities of the consolidated corporation for the unsecured debts of its constituent companies as in truth resting upon the agreement, express or implied, of the consolidated corporation to pay such debts; and this, we think, upon principle, is, in such case, the true ground on which the obligation rests.

"In *Morrison v. American Snuff Co.*, 79 Miss. 330, 30 So. 723, 89 Am. St. Rep. 598, this is said: 'The foundation of the liability of a consolidated corporation may rest on a statute, or on an agreement, either express or implied. *If the statute does not provide that the new company shall assume the debts and liabilities of the constituent companies,* and there is no expressed agreement respecting the same, the debts of the original companies follow as an incident of the consolidation and become by implication the obligations of the new corporation.' (Citing authorities.)

"The consolidated company has in its hands property which, in equity and good conscience, belongs to the plaintiff to the extent of having his claim satisfied thereby; and, wherever property, or money, is so held, 'the law operating on the acting parties creates the duty, establishes the privity and implies the promise and obligation on which the action is founded.' *Brewer v. Dyer*, 7 Cush. (Mass.) 339. See to the same effect, *Moses v. Macferlan*, 2 Burrow 1012; Clark on Contracts, sec. 314, p. 757; *Norfolk v. Norfolk County*, 120 Va. 356, 91 S. E. 820; 2 R. C. L., sec. 9, pp. 749-750.

"Where the circumstances are such that the law implies the promise on the part of the consolidated corporation to pay the liabilities of the constituent companies, the situation is precisely the same in principle, as if such promise were an express promise; and the plaintiff for whose benefit such promise exists may recover upon it by action at law against the promisor, upon either of the principles aforesaid. * * *" (Italics added.)

(b) "The Consolidated Company should be deemed to be merely the same as each of its constituents, their existence being continued in it under the new form and name, their liabilities still existing as before, and capable of enforcement against the new company as if no change had occurred in its organization or name." *The Indianapolis, Cincinnati and Lafayette R. R. Co. v. Jones*, 29 Ind. 465 (1868); *Langhorne v. Richmond Ry. Co.*, 91 Va. 369, 22 S. E. 159 (1865). Judge Thompson, in the first edition (1899) of his works on *Corporation* (Volume 7, p. 6978), stated the principle of these cases as follows:

> "• • • The consolidation of two or more corporations is like the uniting of two or more rivers; neither stream is annihilated, but all continue in existence. A new river is formed, but it is a river composed of the old rivers, which exist though in a different form. So it is with a consolidated corporation. A new corporation is formed, but not in the sense which works a destruction of the rights of action existing against the old one. Independently of statute, the better view is that the new one is liable for any debts, obligations, or rights of action of any kind existing in favor of third persons at the time of the consolidation, and may be sued, at law or in equity, to enforce such rights and obligations without agreement to become so answerable, and without any statute imposing the liability."

In *Railroad Company v. Jones, supra*, the Supreme Court of Indiana, after stating the above quoted conclusion, added: "This doctrine seems to spring from the necessities of justice, and, so far as we are able to foresee, cannot result in wrong or in embarrassment." This is, in effect, an application of the common law principle of implied contracts which Blackstone in his Commentaries, Vol. 2, p. 443, defined as "such as reason and justice

dictate, and which therefore the law presumes that every man undertakes to perform."

Petitioner asserts (Petitioner's Brief, pp. 28-29) that "It is only where the statute governing consolidations or mergers requires the successor to assume the debts and permits that corporation to be sued upon them as if they were its own debts, that there is liability by operation of law." Petitioner has not cited a single case in support of this statement except the case of *General Gas and Elec. Corp.* now before this Court, and we submit that this assertion is contrary to all other authority on the subject.

### *E. The Case of Merwine v. Mt. Pocono Light & Improvement Company*, 304 Pa. 517.

The Circuit Court of Appeals for the Second Circuit in the *General Gas & Electric Corporation* case coupled the absence from the Act of 1874 of a provision making the successor corporation liable for the debts of its predecessor with the refusal of the Court in the *Merwine** case to substitute the successor corporation as defendant in a suit for a tort committed by the merged corporation as showing "that under the Act of 1874, the purchasing corporation does not succeed, simply by operation of law, to the liabilities of the seller".

We submit that the Court misinterpreted the Merwine decision.

In that case the appellant had sued to recover damages for personal injuries. Defendant's attorneys filed a suggestion setting forth that subsequent to the date of commencing the action the property and franchises of the defendant had been conveyed to Pennsylvania Power & Light Co. in proceedings under the Act of 1874, as amend-

* In Petitioner's Brief, p. 25, he inadvertently states that Respondent was the successor corporation in *Merwine v. Mt. Pocono Lt. & Imp. Co.* Respondent is in no way connected with Pennsylvania Power & Light Company, or its holding company, it being an independent operating company.

ed; they alleged that under the Act the defendant had ceased to exist and prayed that the action should be abated. Plaintiff filed an answer and prayed that a rule be allowed to show cause why the Pennsylvania Power & Light Co. should not be substituted as defendant. Pennsylvania Power & Light Co. then interposed the statute of limitations as its defense. The court below abated the action and denied the prayer of the plaintiff.

Two questions, therefore, were before the Supreme Court: did the court below err (1) in abating the action against the Mt. Pocono Company, and (2) in refusing to substitute Pennsylvania Power & Light Company as defendant.

(1) In determining the first question, the Court considered the provision of the Act of 1874 that upon completion of the transaction authorized thereby "such corporation shall cease to exist". It pointed out that the defendant was seeking to avoid liability on the ground that it no longer existed, but that the Act "obviously was not intended to work such hardship," and although the defendant did cease to exist for the purpose of carrying on the business for which it was created, "we find nothing in the statute * * * which forces upon the creditor-plaintiff the injustice of having her suit, which must be presumed to be based upon a legitimate claim, summarily abated". In arriving at this conclusion the Court referred, by way of analogy, to several examples of protection given creditors, among them being the reversal of the common law doctrine that debts were totally extinguished upon the civil death of a corporation; the continued liability of a corporation after dissolution under the Act of the Commonwealth of Pennsylvania of May 21, 1881, and the holding by the Supreme Court of Pennsylva-

nia in the case of *B. & S. R. R. Co. v. Musselman* (quoted, *infra*, pp. 43-44) that suits pending against corporations which consolidated did not abate.

The Court held, therefore, that the action against the Mt. Pocono Company did not abate, and ruled

> "* * * that the proper course at the present state of proceedings requires plaintiff first to proceed to judgment against defendant [Mt. Pocono Co.] if she can, and, having secured judgment, to levy where defendant's assets liable for the judgment may be found" [i. e., seize the property in the hands of Pennsylvania Power & Light Co.]. (Matter in brackets added.)

That this was the intent of the direction is made clear in *Weinroth v. Homer B. & L. Association*, 310 Pa. 265, where, in referring to the *Merwine* case, the Court said:

> "The court there directed plaintiff, if he recovered judgment, to pursue the property of the defendant in the possession of the *merged* company."

In other words, the Court held that the words "cease to exist" in the Act of 1874 meant that the Mt. Pocono Company's right to carry on business had been terminated, but it remained a corporation for the single purpose and with the sole power of being sued or proceeded against and defending itself in causes of action brought against it before the consummation of the transaction. If it were subjected to judgment, levy would be made against Pennsylvania Power & Light Company.

The status of the Mt. Pocono Company, as defined by the Court, is entirely consistent with the previous consummation of either a merger or a consolidation. In *American Ry. Exp. Co. v. Downing*, 132 Va. 139, *supra*, pp. 31-32, the Court said:

"It is not essential to the new corporation being considered as a *consolidated company,* within the meaning of those terms as used in the authorities * * * nor to the liability of the new corporation above referred to, that the constituent companies should cease to exist *de jure* upon the organization of the new corporation. The going 'out of existence' of the constituent companies * * * is the cessation of all actual transaction of business as a going concern —the *de facto* cessation of all business—the abandonment of all life and operation according to the design of the charter of the constituent companies. The continued existence *de jure* of the constituent companies, for the purpose of winding up their affairs or other purposes, is immaterial. * * *"

This subject is further discussed at pages 43-45 of this brief.

(2) In support of the alternative contention that the court below erred in refusing to substitute Pennsylvania Power & Light Co. as defendant, counsel for appellant had contended in his brief (p. 518 of opinion) that "The transaction was a merger, not a sale." In considering this contention, the Court said, at pages 524-525:

"Although we need not decide the point, it is proper to call attention to the fact that the pleadings indicate that the Pennsylvania Power & Light Company took over the property of defendant under circumstances warranting a finding, upon evidence produced to support the allegations in the pleadings, *that the transaction between the two corporations was in reality a merger, or such union of interests as, in law, caused the buying corporation to assume defendant's obligations.* There is much to show that the purchase was attended by an intimacy of interest tending to render the transaction, in so far as the Pennsylvania Power & Light Company's interest

was concerned, a purchase cum onere. For instance, it is averred that, at the time of the commission of the alleged negligent acts on the part of the Mount Pocono Light & Improvement Company, it was affiliated or associated with the Pennsylvania Power & Light Company to the extent that both companies were managed, operated and controlled under the same management and system. It is admitted that the common stock of both companies was owned by the same holding company, and, by defendant's own showing, thirteen of the same persons were officers or directors in both companies. It further appears that both companies operated from the same office. Plaintiff states that the business of the Mount Pocono Company was conducted by the agents, servants and employees of the Pennsylvania Power & Light Company; that after the sale, the power company took over and operated the business formerly conducted by defendant; and that the sale was merely a formality giving effect to a union of the companies which had in reality occurred previous to the accident upon which the suit is based. * * *" (Italics added.)

This is a definite statement by the Court that the transfer by the subsidiary corporation (under the procedure prescribed by the Act of 1874, as amended) of its franchises and property to the corporation with which it was affiliated, under circumstances similar to those of the case at bar, was merely a formality and the transaction in reality was a merger of the two companies, the corporation acquiring the franchises and property becoming liable *by operation of law* for the torts and debts of the merged subsidiary.

Nowhere did the Court say in the *Merwine* case that the successor corporation, Pennsylvania Power & Light Co., could not be sued by the plaintiff. Indeed, the Court, although saying it did not decide the point, expressly called

attention to the fact that the contrary was the case if the allegations of the pleadings were proved.

The plaintiff's prayer in the *Merwine* case that Pennsylvania Power & Light Co. be substituted as defendant was an alternative in the event that the suit against the Mt. Pocono Company abated, and the Court, having held that it did not abate, affirmed the order of the lower court denying the substitution, but expressly "without prejudice to plaintiff".

The results of the *Merwine* case, namely,

(1) the holding that the plaintiff's suit against the merging subsidiary was not abated; that the suit might be pursued to judgment, and levy made against the property in the hands of the successor, and

(2) the indication of the Court that the successor was liable because "the pleadings indicate * * * that the transaction between the two corporations was in reality a merger, or such union of interest as in law caused the buying corporation to assume the defendant's obligations,"

are exactly the same as the result of a merger under Article IX of the Pennsylvania Corporation Laws of 1933, Section 907 of which provides:

> "* * * any claim existing or action or proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger * * * had not taken place, *or* the surviving * * * corporation may be proceeded against or substituted in its place. * * *"

Mr. Shockley in his annotation of this section notes that similar provisions are in the Uniform Business Corpora-

tion Act (Sec. 47), approved by the National Conference of Commissioners on Uniform State Laws, and the Corporation Laws of Delaware, New Jersey, New York, Maryland, Indiana, Ohio, Michigan and California.

Petitioner admits (Petitioner's Brief, p. 26) that the Court, in the *Merwine* case, "did suggest that * * * the purchaser might be liable for the debts of the seller," but he says the Court "made no suggestion that it was liable under the statute itself." We have shown above (pp. 28-34) that the omission of such a provision from the early merger and consolidation statutes was not unusual, but notwithstanding this fact the successor was held liable. The phrase liability "by operation of law" expresses the manner in which liabilities devolve upon a person by the application to the particular transaction of established rules of law without any specific act of the party himself. The liability is equally "by operation of law" whether specifically provided by statute or imposed upon the successor by the courts as a necessary result of the transaction.

That this is true is apparent from the opinion of the Circuit Court of Appeals for the Second Circuit in *American Gas & Electric Co. v. Commissioner*, 85 Fed. (2d) 527, 531, in which the Court, in permitting the successor corporation to deduct discount on bonds issued by its predecessor, relied upon *American Ry. Exp. v. Downing*, 132 Va. 139 (see *supra*, pp. 31-32) as showing that "the transferee corporation succeeds by operation of law to all the rights and liabilities of the former company." In that case no liability was imposed upon the successor by statute, nevertheless the Court held the successor liable as an implication of the transaction.

### *F. Liability of Successor Corporation on Principle of Fraudulent Conveyance*

Petitioner contends (Petitioner's Brief, p. 27) that the Supreme Court of Pennsylvania, in the *Merwine* case, by its reference to "a purchase *cum onere*" meant that the successor was liable on the principle of fraudulent conveyances.

The phrase "*cum onere*" does not imply a fraudulent conveyance. This Court, in *Mt. Pleasant v. Beckwith*, 100 U. S. 514 (*supra*, pp. 28-30), in considering a merger of towns by an Act of the legislature, rested liability of the successor on "the rule • • • that the successor who takes the benefits must take the same *cum onere*," yet it is impossible to apply to that case the principle of fraudulent conveyances. The same is true of the case of *Thompson v. Abbott*, 61 Mo. 176, 177, *supra*, pp. 28, 31, cited with approval by this Court in the above case.

In none of the cases above referred to (pp. 28-34), in which the consolidated corporation was held liable for debts of the predecessor in the absence of statutory provision, did the court rest such liability on the principle of fraudulent conveyance.

Creditors' remedies in mergers, consolidations and fraudulent conveyances are similar in that one of the remedies allowed creditors in Pennsylvania in the case of mergers and consolidations and also one of the remedies in case of fraudulent transfers, where the purported sale is treated as a nullity, is to levy directly on the assets in the hands of the holder. This similarity of remedy, however, does not mean that either mergers or consolidations are fraudulent transfers. Thus, in

*Berkovitz's Appeal*, 319 Pa. 397, the Supreme Court of Pennsylvania noted the similarity of remedy, saying:

> "• • • we have also decided in other cases that creditors of one corporation may follow the property or assets of such corporation into a new corporation where there has been a merger, *or*, in cases of fraudulent transfer. See Halpern v. Grabosky, 296 Pa. 108, 111; Merwine v. Mt. Pocono, 304 Pa. 517, 522; Delphia Knitting Mills Co. v. Richards, 62 Pa. Superior Ct. 9, 12." (Italics added.)

In the *Merwine* case the Court referred to the note to *Mumma v. The Potomac Co.*, 8 Peters 281, printed in 8 L. Ed. at pp. 945-946, stating that the common law doctrine that upon the civil death of a corporation all debts due to or from it were totally extinguished had been superseded by the trust fund doctrine under which a court of equity will lay hold of the funds of such a corporation and see that they are applied to the payment of debts. This reference to the trust fund doctrine was not intended by the Court to indicate that in the case of a merger a creditor of the merging corporation would have to apply to a court of equity for the enforcement of his claim, but was simply an illustration of the fact that courts will not, in this age, permit just claims to be defeated on technical grounds.

*G. Continuance of the Existence of Merging or Consolidating Corporations Within the Successor.*

Petitioner in his brief repeatedly asserts that one of the essentials of a true merger or consolidation is the preservation of the existence of the transferor corporations within the successor corporation. He cites *American Gas and Elec. Co. v. Commissioner*, 85 Fed. (2d) 527, *American Gas and Electric Co. v. United States*, 17 F.

Supp. 151, and *General Gas and Elec. Corp. v. Commissioner,* now before this Court, in support of this assertion (Pet.'s Brief, p. 29). The statement in these cases that the merger or consolidation transaction must be one "which essentially preserved the identity of the transferor" within the transferee is simply a way of expressing the idea that in a true merger or consolidation there must be an amalgamation of interests, as contrasted from a divorcement, and the property, powers and franchises of the merging corporations must be transferred as an entirety to the successor corporation, subject to its debts and liabilities, and thereafter the merging corporations cease to exist in the sense that they have been stripped of all property, rights and franchises and cannot engage in business.

It does not mean, as Petitioner contends in his brief, that the transferring corporation must cease to exist in the absolute sense, and cannot remain alive for the special purpose of defending or prosecuting suits. The Supreme Court of Pennsylvania made this clear as far back as 1856 in the case of *Balto. and Susq. R. R. Co. v. Musselman,* 2 Grant's (Pa.) Reports 348. The question in that case was whether a suit brought against the Railroad Company prior to its consolidation had been abated by reason of the "death" of the corporation in the consolidation proceedings. In holding that the suit had not abated because of a provision of the statute authorizing the consolidation, the Court said—

> "But, without any such provision as the above, in the law authorizing the consolidation [referring to the provision making the merging corporations liable for their debts] a court of justice would not consider the mere voluntary union of several corpo-

> rations into one, as equivalent to the death of either * * *. It is not a case of death, for the new corporation lives from the life of the old one; their several lives are transferred into it; and unlike ordinary cases of metempsychosis, this translation is accompanied by full consciousness of the former state, and its liabilities."

The Court therefore held that while there was what might be termed a "reincarnation" of the constituent corporations in the successor, the constituent corporations remained alive for the purpose of defending suits.

As pointed out in this brief at pp. 39-40, the Pennsylvania Corporation Law of 1933, Sec. 47 of the Uniform Business Corporation Act and the laws of many states provide that after mergers or consolidations, suits may be prosecuted against the constituent corporations.

The idea of the continued existence of the transferring corporation within the successor is thus expressed in *Mercantile Trust Co. v. San Joaquin Agricultural Corporation*, 89 Cal. App. 558, 265 Pac. 583 (1928)—

> "It is true that each of the consolidated banking corporations, as a distinct, independent, and separate corporate entity, practically passes out of existence or becomes extinct upon completion of the act of consolidation. But, unlike in cases of dissolution, their corporate activities do not cease but are continued and are prosecuted and carried on through a new channel—a channel created solely by their voluntary act under the sanction of the law for that specific purpose. Speaking figuratively, the act of consolidation is merely the joint transfusing of the blood of the constituent corporations into the veins and arteries of a new single corporate entity, that they may enlarge and extend the scope and business ram-

ifications of their own corporate purposes and also to impart enhanced solidity to their responsibility as banking and trust corporations."

We submit that the existence of the Holtwood Company was continued within Respondent. Under the Act of 1874 "its franchises, (this term being "generic" and meaning all the rights granted by the legislature, *Atl. and Gulf R. Co. v. Georgia*, 98 U. S. 359, 365) and all its property, real, personal and mixed" were transferred to Respondent, which became liable by operation of law for Holtwood Company's debts.

The Act of 1874 expressly provides that upon the completion of such a transaction the transferring "corporation shall cease to exist." It is true that in the case of *Merwine v. Mt. Pocono Lt. & Imp. Co., supra*, the Supreme Court of Pennsylvania held that the transferring corporation had not passed out of existence in the absolute sense and an action brought against it prior to the merger had not abated. But the Court did point out that if such a corporation attempted to resume business, it could be stopped by a quo warranto proceeding. This holding was in accord with the accepted rule as to the status of a merging corporation.

### *H. If Merger Had Not Taken Place Deduction of Bond Discount and Expense Would Not Have Been Questioned by Petitioner.*

If the merger of Holtwood Company into Respondent had not taken place in 1927 the unamortized bond discount and expense would have been deductible by Respondent whether separate or consolidated tax returns were made.

Paragraph 3 (c) of the agreement of August 26th, 1924, between Holtwood Company and Respondent (R. 34-35) obligated Respondent to pay to Holtwood Company "A sum to provide for amortization of debt, discount, and security issue expense." This provision would have required Petitioner (if separate tax returns had been made) to admit Respondent's right, in computing its income tax, to deduct the unamortized discount and expense paid to Holtwood Company because the payment of these items would have been part of the cost of the power delivered to Respondent from Holtwood's plant. These payments to Holtwood Company would have been considered as income to that Company, but the whole amount thereof would have been deductible by it as expense, so there would have been no income tax assessable against Holtwood Company as a result of the transaction.

Section 142 of the Revenue Act of 1928 authorized corporations with common ownership to make consolidated tax returns. The purpose of this section was to provide a method of computing the tax upon the true net income of a business which was in reality a single enterprise though conducted by two or more corporations. *Atlantic City Elec. Co. v. Commissioner*, 288 U. S. 152. p. 154. From the time of the incorporation of the Holtwood Company to its merger with Respondent consolidated tax returns were made for these corporations. If the merger had not taken place, a consolidated return would doubtless have been made for 1928. In such a return, inter-company transactions would have been eliminated and the unamortized discount and expense deductible in computing Respondent's taxable income. (Statement of Evidence, par. 9, R. 30-31.)

Respondent, therefore, is not endeavoring to obtain any additional deduction from income by reason of the merger. It contends that it would be unjust to require it to pay a large tax because of a technical change in the title to its steam generating plant which was purely a formality and did not involve any change in substance.

*I. Cases Disallowing Deductions of Discount to Successor Corporation Distinguished.*

The case at bar is clearly distinguishable from the cases in which deductions on account of amortization of bond discount and expense have been disallowed to successor corporations, viz., *Turner-Farber-Love Co. v. Helvering*, 68 Fed. (2d) 416 (1933); *American Gas & Electric Co. v. Commissioner*, 85 Fed. (2d) 527 (1936); and *American Gas & Electric Co. v. United States*, 17 Fed. Sup. 151, 85 Ct. Cl. 92 (1936). In these cases the corporations did not merge or consolidate, and the transactions in question were simply sales of the assets of one corporation to another for either cash or marketable securities. The vendor corporation was not dissolved by operation of law but could continue "to do any business its corporate charter authorized," and further, as the Circuit Court of Appeals and the Court of Claims suggested in the *American Gas & Electric Co.* case, the purchase price was such that it could be and probably was adjusted because the vendee would have to pay the bonds in full. No consideration was paid by Respondent to Holtwood Company which could be adjusted, or reduced, because of the unamortized discount and expense. Upon the completion of the "short form" merger Holtwood Company "ceased to exist" as provided in the Act of 1874, as amended, and it therefore could not engage in any business.

*J. Cases Denying to Successor Corporations Deductions for Losses Suffered by Predecessors.*

Petitioner refers (Petitioner's Brief, pp. 39-41) to the following cases holding that a successor corporation taking over the assets of another and assuming its liabilities is not entitled to deduction for losses which the predecessor might have claimed: *New Colonial Co. v. Helvering*, 292 U. S. 435; *Athol Mfg. Co. v. Commissioner*, 54 Fed. (2d) 230 (C. C. A. 1); *Brandon Corp. v. Commissioner*, 71 Fed. (2d) 762 (C. C. A. 4); *Cem Securities Corp. v. Commissioner*, 72 Fed. (2d) 295 (C. C. A. 4); *May Oil Burner Corp. v. Commissioner*, 71 Fed. (2d) 644 (C. C. A. 4); *Shreveport Producing & Refining Co. v. Commissioner*, 71 Fed. (2d) 972 (C. C. A. 5); *Dalton v. Bowers*, 287 U. S. 404; *Burnet v. Clark*, 287 U. S. 410; *Burnet v. Commonwealth Imp. Co.*, 287 U. S. 415; *Planters Oil Co. v. Hopkins*, 286 U. S. 332.

These cases have no application to the case at bar because they all relate to losses sustained by the predecessor prior to the transfer of its property.

Bond discount is in reality deferred interest although the payment of it has been called a loss. Thus in *W. Md. Ry. Co. v. Commissioner*, 33 Fed. (2d) 695, 696, the Court said—

> "Bond discount is in reality additional interest payable upon the maturity of the bonds, and a proportionate part of it accrues each year and should be treated as interest paid or accrued on the bonds for that year."

Also see:

*Chicago, R. I. and Pac. Ry. Co. v. Commissioner*, 13 B. T. A. 988, 1031, 1033.

The Circuit Court of Appeals for the Second Circuit in holding, in the case of *New York Cent. R. R. Co. v. Commissioner*, 79 Fed. (2d) 247, 249, that bond discount on bonds issued by a predecessor was deductible by the successor either by consolidation or merger, said:

> "In the case at bar, no loss was sustained by the issuing corporations in selling their bonds at a discount; the loss will be sustained by the consolidated corporation when the bonds mature and are paid. Hence the deductions here in question are by way of anticipation of the taxpayer's own loss and should have been allowed."

To the same effect is *Helvering v. Union R. R. Co.*, 293 U. S. 282, 286, 287.

Whether unamortized bond discount paid at the time of calling bonds prior to maturity is called deferred interest or loss is immaterial. Under either theory it is an expense of the successor corporation and not a loss of the predecessor corporation which issued the bonds.

Petitioner says in his brief at p. 46 that the Circuit Court of Appeals for the Second Circuit repudiated the above quoted statement in the *New York Cent.* case in its subsequent decision in *American Gas and Elec. Co. v. Commissioner*, 85 Fed. (2d) 527, and held that the bond discount loss was an expense of the issuing corporation. We do not so read the opinion. In speaking of the bonds of the Virginian Power Co. and Electric Company of New Jersey the Court said—

> "• • • Where, however, there is a transfer in a reorganization, the loss is likewise that of the issuing corporation, for the reason that, because of the discount and expenses, it had subjected itself to an obligation larger than the amount it received from the bonds. *Because of this increased obligation, the*

*transferor necessarily obtained a less valuable consideration from the transferee at the time of the transfer in reorganization than it would otherwise have received.* Nevertheless, under section 203(b)(4) of the Revenue Acts of 1924 and 1926, no gain or loss is to be recognized upon the transfer. Consequently, where there has been only a partial amortization of discount and expenses and a transfer in reorganization occurs, no further loss will be recognized, and that part of the loss which could not be taken prior to the transfer cannot be taken thereafter. * * *" (Italics added.)

In other words, the purchase price was adjusted for the discount so the loss actually fell upon the issuing corporation. It could not deduct the loss for the reason given by the Court, neither could the transferee take it because it sustained no loss in view of the adjustment in the purchase price.

In considering the bonds of the Appalachian Power Company the Court held that the allowance of the bond discount was governed by its decision in the *New York Cent.* case because there was a merger of the issuing corporation into the Appalachian Electric Power Company.

## IV.

**THE TRANSACTION IN QUESTION INVOLVED A CHANGE IN FORM ONLY AND THEREFORE THE DEDUCTIONS SHOULD BE ALLOWED IRRESPECTIVE OF THE TECHNICAL NATURE OF THE TRANSACTION.**

Holtwood Company, prior to the consummation of the "short form" merger, was simply a department of Respondent in method of operation of its steam-electric generating plant as well as through stock ownership (R. 29-30). After the consummation of the "short form" merger, Respondent was in exactly the same position as be-

fore; its officers and employees were the same; the interests of stockholders were the same and its assets and liabilities were the same. The only difference was that Respondent had title to the steam generating plant directly instead of through a wholly owned agent which had been subject in all things to its direction and control.

In the case of *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 442, cited by Petitioner, this Court said:

> "As a general rule a corporation and its stockholders are deemed separate entities and this is true in respect of tax problems. Of course, the rule is subject to the qualification that the separate identity may be disregarded in exceptional situations where it otherwise would present an obstacle to the due protection or enforcement of public or private rights."

The case of *Southern Pacific Company v. Lowe*, 247 U. S. 330, pp. 337, 338, was referred to (footnote 5) as an example of an "exceptional situation" in which for income tax purposes the separate corporate entity of a wholly owned subsidiary of a railroad should be disregarded. In holding that dividends paid by a subsidiary to its parent company in 1914 from surplus accumulated prior to the adoption of the 16th Amendment were not taxable income, the Court said:

> "We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing 'the entire net income arising or accruing from all sources' during each year commencing the first day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter pos-

sessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, the former being but a part of the latter, acting merely as its agent, and subject in all things to its proper direction and control. * * *"

*Western Maryland Railway Co. v. Commissioner*, 33 Fed. (2d) 695 (C. C. A. 4) (1929), was the first case in which an issue similar to that in the case at bar was considered by the courts. The question there was whether Western Maryland Railway Co., which was formed by the consolidation of its predecessor with seven subsidiaries, all of whose stock it owned and whose property it operated as its own, was entitled to amortize and deduct discount on bonds issued by its said predecessors. The Interstate Commerce Commission required that the unamortized discount be carried on the balance sheet of the consolidated company and amortized over the remaining life of the bonds (which fact is equally true in the case at bar under the accounting rules of the Public Service Commission of Pennsylvania, see R. 32). The Board of Tax Appeals denied the deduction and the Railway Co. appealed.

In reversing the decision of the Board of Tax Appeals, the Court relied upon the principle illustrated by the two cases above cited, saying:

"We come then to the second question in the case: Has the right to deduct the amortized portion of the discount been lost by reason of the reorganization of the corporation that sold the bonds and the taking over of its assets and liabilities by the consolidated company? We think not. In the first place, it is perfectly clear that, although there has been a reorganization and although the consolidated corporation is a distinct legal entity from those whose places

it has taken, nevertheless, in all of its essential relationships, it occupies exactly the same position which they occupied. Its management is the same, its assets are the same, its stockholders are the same, and its obligations are the same, except that the floating indebtedness of the old corporation has been taken up by the first preferred stock of the new, a change which might have been effected by the old corporation without reorganization, and which manifestly can have no bearing upon the matter of bond discount. In other words, the consolidated corporation has stepped into the place of the corporation which issued the bonds, and occupies the same relationship towards them that it occupied. It has received no consideration for its agreement to pay them except the assets of the old corporation which have been transferred to it. It has the same property as the old corporation, owes the same bonded debt, and is bound to pay it in the same way. The Interstate Commerce Commission requires that the unextinguished discount be carried on the balance sheet of the company and that same be amortized by charge against income for the remaining life of the bonds, just as though no reorganization had taken place; and, if the deduction is to be allowed as a basis for rate making and for determining the rights of the government under the recapture clause of the Transportation Act, there is no reason why it should not be allowed in determining the basis of taxation also. *After all, while there is a technical legal difference between the old and the new corporations, they are the same as a practical matter, both holding the same property and representing the same ownership, and it is a settled principle that 'courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require'.* Chicago, Milwaukee & St. Paul R. Co. v. Minneapolis Civic

Ass'n., 247 U. S. 490, 501, 38 S. Ct. 553, 557 (62 L. Ed. 1229); Southern Pac. Co. v. Lowe, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142; Gulf Oil Corporation v. Lewellyn, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133.

*"The rule just stated is of peculiar importance in tax cases; for, unless the courts are very careful to regard substance and not form in matters of taxation, there is grave danger on the one hand that the provisions of the tax laws will be evaded through technicalities and on the other that they will work unreasonable and unnecessary hardship on the taxpayer.* It is instructive to note the many tax cases decided in recent years in which the courts have not hesitated to ignore corporate forms, and to decide the questions involved in the light of what the parties have actually done, rather than on the basis of the forms in which they have clothed their transactions. See Weiss v. Stearn, 265 U. S. 242, 44 S. Ct. 490, 68 L. Ed. 1001, 33 A. L. R. 520; U. S. v. Phellis, 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180; Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570; Gulf Oil Corp. v. Lewellyn, supra; Alpha Portland Cement Co. v. U. S. (C. C. A. 3d), 261 F. 339; Appeal of A. J. Siegel, 4 B. T. A. 186; Appeal of H. E. Brubaker, 4 B. T. A. 1171. *We think, therefore, that as the new corporation, while technically a distinct legal entity, is to all practical intents and purposes a mere continuation of the old, it is entitled to the same deduction on account of amortized bond discount that the old corporation would have been entitled to if the reorganization had not taken place."* (Italics added.)

This rule of disregarding corporate entity, we contend, should be applied in the case at Bar. Holtwood Company and Respondent were for all practical purposes merged from the date of the organization of the Holtwood Company. Respondent, therefore, should not be required to

ay the tax in question because it went through the for-
nality of eliminating a legal concept—Holtwood Com-
any—after its maintenance was found to be no longer
ecessary in order to comply with the laws of Pennsyl-
ania.

## CONCLUSION.

The decision of the Court below was right and should be
ffirmed.

Respectfully submitted,

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February 2, 1939.

## APPENDIX A.

### Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

### United States Internal Revenue Regulations No. 74.

Art. 68. *Sale and retirement by corporation of its bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price

or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (a) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess

of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

**Treasury Decision 4603.**

Collectors of Internal Revenue and Others Concerned:

In determining the deductions for income tax purposes of items in respect of the refunding of bonds, the following rules shall apply in the instances specified:

(a) In the case of a retirement of an issue of old bonds from the proceeds of the sale of new bonds any amount paid in excess of the face value of the old bonds, less any amount of premium received when issued and not already returned as income, and any unamortized discount and unamortized expense attributable to such bonds, is deductible in the taxable year of their retirement. However, pursuant to the discretion vested in the Commissioner, with the approval of the Secretary, by section 1163(a) of the Revenue Act of 1926, as finally amended by section 506 of the Revenue Act of 1934, in the case of such retirement of an old issue of bonds prior to the date of the approval of this Treasury decision, the tax for the year of retirement and subsequent taxable years will be determined on the basis of the ruling of the Bureau of Internal Revenue heretofore in existence to the effect that the items mentioned in the first sentence hereof should be pro-rated and amortized over the life of the new bonds, (1) if the taxable year in which the retirement occurred has been closed on that basis and the tax for such year can not be redetermined, or (2) if, where the taxable year in which such retirement occurred remains open, the taxpayer by a written communication addressed to and filed with the Commissioner of Internal Revenue, Washington, D. C., on or before January 1, 1936, gives notice of its election to have its taxes determined in accordance with such old ruling, and expressly waives in

such written communication its right to claim a refund or credit on the ground that such items are deductible in the taxable year in which the retirement occurred.

(b) In the case of a retirement of an issue of old bonds in part by exchange for new bonds and in part by payment in cash: (1) In respect of the portion of the old bonds retired with cash any amount paid in excess of the face value of the old bonds, less any amount of premium received when issued and not already returned as income, and any unamortized discount and unamortized expense attributable to such bonds, is deductible in the taxable year of their retirement, subject to the exception stated in paragraph (a) above; (2) in respect of the portion of the old bonds exchanged for new bonds such items shall be amortized over the life of the new bonds.

(c) In the case of a retirement of old bonds in exchange for new bonds of the same or a greater face value, or by the exchange for new bonds plus a bonus in cash, such items shall be amortized over the life of the new bonds.

(d) In the case of a retirement of old bonds from the proceeds of the sale or issue of capital stock such items are deductible in the year in which the old bonds are retired. In the case of a retirement of old bonds through conversion or exchange for shares of capital stock of the obligor no deduction shall be allowed on account of the unamortized balances of such items in the year the bonds are retired nor shall any amortization allowances be made in respect of such items for subsequent taxable years.

WRIGHT MATTHEWS,
Acting Commissioner of Internal Revenue.

Approved November 9, 1935.

**United States Internal Revenue Regulations No. 74.**

Art. 141. *Interest.*— * * * Interest paid by the taxpayer on a mortgage upon real estate of which he is the

legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. * * *

## APPENDIX B.

### Applicable Sections of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as Amended.

**(Purdon's Pennsylvania Statutes, Annotated, Title 15, Secs. 262-266, 595.)**

Section 18. The capital stock or indebtedness of any corporation to be created under the provisions of this statute, or accepting its provisions, may be increased, from time to time, by the consent of the persons or bodies corporate holding the larger amount in value of the stock of such company, to such amount as such corporation is by this act authorized to increase its capital stock or indebtedness, but such increase shall only be made for money, labor done, or money or property actually received.

Section 19. Any such corporation desirous of increasing its capital stock or indebtedness as provided by this act, shall, by a resolution of its board of directors, call a meeting of its stockholders therefor, which meeting shall be held at its chief office or place of business in this commonwealth; and notice of the time, place and object of said meeting, shall be published once a week for sixty days prior to such meeting, in at least one newspaper published in the county, city or borough wherein such office or place of business is situate.

Section 20. At the meeting called, pursuant to the nineteenth section of this act, an election of the stockholders of such corporation shall be taken for or against such increase, which shall be conducted by three judges, stockholders of said corporation, appointed by the board of directors to hold said election, and if one or more of

said judges be absent, the judge or judges present shall appoint a judge or judges, who shall act in the place of the judge or judges absent, and who shall respectively take and subscribe an oath or affirmation before an officer authorized by law to administer the same, well and truly, and according to law, to conduct such election to the best of their ability; and the said judges shall decide upon the qualification of voters, and when the election is closed count the number of shares voted for and against such increase, and declare whether the persons or bodies corporate holding the larger amount of the stock of such corporation have consented to such increase, or refused to consent thereto, and shall make out duplicate returns of said election, stating the number of shares of stock that voted for such increase and the number that voted against such increase, and subscribe and deliver the same to one of the chief officers of said company.

Section 21. Each ballot shall have endorsed thereon the number of shares thereby represented, and be signed by the holder thereof, or by the person holding a proxy therefor; but no share or shares transferred within sixty days shall entitle the holder or holders thereof to vote at such election or meeting, nor shall any proxy be received, or entitle the holder to vote, unless the same shall bear date and have been executed within three months next preceding such election or meeting; and it shall be the duty of such corporation to furnish the judges at said meeting with a statement of the amount of its capital stock, with the names of persons or bodies corporate holding the same, and number of shares by each respectively held, which statement shall be signed by one of the chief officers of such corporation, with an affidavit thereto annexed that the same is true and correct to the best of his knowledge and belief.

Section 22. It shall be the duty of such corporation, if consent is given to such increase, to file in the office of the secretary of the commonwealth, within thirty days

after such election or meeting, one of the copies of the return of such election provided for by the twentieth section of this act, with a copy of the resolution and notice calling same thereto annexed; and upon the increase of the capital stock or indebtedness of such corporation made pursuant thereto, it shall be the duty of the president or treasurer of such corporation, within thirty days thereafter, to make a return to the secretary of the commonwealth, under oath, of the amount of such increase and terms of the same, that is to say, the terms on which additional stock is issued; and in case of neglect or omission so to do, the corporation shall be subject to a penalty of five thousand dollars, which penalty shall be collected on an account settled by the auditor general and state treasurer, as accounts for taxes due the commonwealth are settled and collected; and the secretary of the commonwealth shall cause said returns to be recorded in a book to be kept for that purpose, and furnish a certified copy of the same to the auditor general, and the corporation shall have the right to recover the same from the officer neglecting or omitting to file the return as aforesaid.

Section 23. Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value or the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: Provided,

That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date. * * *

## APPENDIX C.

### Long Form Merger Act of May 3, 1909.

### (Purdon's Pennsylvania Statutes, Annotated, Title 15)

SEC. 421. *Merger authorized; exceptions; exclusive franchise not extended; merger subject to act of 1907.*

It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation in which such merger shall be made: * * *

SEC. 422. *Procedure; joint agreement; approval by stockholders; certificates; approval by governor.*

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers, herein set forth; to wit,—

First. The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, and who shall be the first directors and officers, and their places of residence, the number of shares of the capital stock, the amount or par value of each share, and the manner of converting the capital stock of each of said corporations into the stock of the new corporation, and how and when directors and officers shall be chosen, with such other details as they shall deem necessary to perfect the said consideration and merger; but said agreement shall not be effective unless the same shall be approved by the stockholders of said corporations in the manner hereinafter provided.

Second. Said agreement shall be submitted to the stockholders of each of said corporations, at separate special meetings or at any annual meetings, of the time, place and object of which respective meetings due notice shall be given by publication, once a week for two consecutive weeks before said respective meetings, in at least one newspaper in the county or in each of the counties in which the principal office of said respective corporations shall be situate,—excepting in the case of the merger or consolidation of corporations which, upon their original incorporation, are required by the Constitution to publish notice of intention to incorporate for a longer period than two weeks, in which case notice by publication shall be as required by the Constitution, —and at said meetings the said agreement of the directors shall be considered, and a vote of the stockholders in person or by proxy shall be taken, by ballot, for the adoption or rejection of the same, each share of stock entitling the holder thereof to one vote; and if a majority in amount of the entire capital stock of each

of said corporations shall vote in favor of said agreement, merger and consolidation, then that fact shall be certified by the secretary of each corporation, under the corporate seal thereof, and said certificates, together with the said agreement or a copy thereof, shall be filed in the office of the Secretary of the Commonwealth, who shall forthwith present the same to the Governor for his approval and when approved by the Governor the said agreement shall be deemed and taken to be the act of consolidation of said corporation.

SEC. 423. *Effect of merger; new patent; bonus; certificate of reports and payment of taxes.*

Upon the filing of said certificates and agreement, or copy of the agreement, in the office of the Secretary of the Commonwealth, and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the said corporations to be one corporation under the name adopted in and by said agreement possessing all the rights, privileges, and franchises theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: *Provided,* That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. But such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from

the Governor of the Commonwealth new letters patent, and shall have paid to the State Treasurer a bonus, as prescribed by law, upon all its capital stock in excess of the amount of capital stock of the several corporations so consolidating, upon which the bonus required by law has been theretofore paid: *And provided further,* That new letters patent of such consolidated corporation shall not be issued by the Governor of the Commonwealth, until each corporation entering into and forming the consolidated corporation shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed merger, and that all taxes due the Commonwealth of Pennsylvania have been paid, up to and including said date.

## APPENDIX D.

### Pennsylvania Corporation Laws of 1933.

Section 901. *Merger and Consolidation Authorized.* A. Any two or more domestic business corporations, or any one or more foreign business corporations, may, in the manner hereinafter provided in this article, be merged into one of such domestic business corporations, hereinafter designated as the surviving corporation, or consolidated into a new corporation to be formed under this act, provided such foreign business corporations are authorized by the law or laws of the jurisdiction under which they were formed to effect such merger or consolidation.

B. Any one or more domestic business corporations, and any one or more foreign business corporations, may, in the manner hereinafter provided in this act, be merged into one of such foreign business corporations, hereinafter designated as the surviving corporation, or consolidated into a new corporation to be formed under the law or laws of the jurisdiction under which one of the foreign

business corporations was formed, provided the laws of such jurisdiction authorize such merger or consolidation.

Section 902. *Approval of Joint Plan of Merger or Consolidation.* A. The board of directors of each of the corporations which desire to merge or consolidate shall, by resolution adopted by at least a majority vote of all the members of each board, approve a joint plan of merger or consolidation, as the case may be, setting forth the terms and conditions of the merger or consolidation and mode of carrying the same into effect, the manner and basis of converting the shares of each corporation into shares or other securities or obligations of the surviving or new corporation, as the case may be, and such other details and provisions as are deemed necessary.

B. The board of directors of each corporation, upon approving such plan of merger or plan of consolidation, shall, by resolution, direct that the plan be submitted to a vote of the shareholders of such corporation entitled to vote thereon, at an annual or special meeting of the shareholders. Written notice shall, not less than ten days before such annual or special meeting, be given to each shareholder of record of such corporation, whether or not entitled to vote on such plan, unless the plan of merger or plan of consolidation contemplates an increase in the aggregate of the authorized capital stock of the constituent corporations, in which event, sixty days' notice of such meeting shall be given to each shareholder. The notice shall state the place, day, hour and purpose of the meeting, and a copy or a summary of the plan of merger or plan of consolidation, as the case may be, shall be included in or enclosed with such notice.

C. The plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of at least the majority of the outstanding shares entitled to vote thereon of each of the merging or consolidating corporations, unless any class of shares of any of such corporations is entitled to vote thereon as a class, in

which event, as to such corporation, the plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of at least a majority of the outstanding shares of each class of shares entitled to vote thereon as a class, and the affirmative vote of the holders of at least a majority of all outstanding shares entitled to vote thereon.

Section 903. *Articles of Merger or Consolidation.* Upon the approval of the plan of merger or the plan of consolidation by the shareholders of the corporations desiring to merge or consolidate, articles of merger or articles of consolidation, as the case may be, shall be executed under the seal of each corporation, signed and verified by two duly authorized officers of each corporation, and shall set forth:

(1) The name and the location of the registered office of the surviving or new corporation.

(2) The time and place of the meeting of the shareholders of each corporation at which the plan of merger or consolidation, as the case may be, was adopted, the kind and period of notice given to the shareholders, and the total vote by which the plan was adopted.

(3) Any changes desired to be made in the articles of the surviving corporation in the case of a merger, or, in the case of a consolidation, all of the statements required by this act to be set forth in original articles in the case of the formation of a corporation.

(4) The number, names and addresses of the persons to be the first directors of the surviving or new corporation.

(5) The plan of merger or consolidation.

Section 904. *Advertisement.* The corporation shall advertise its intention to file articles of merger or articles of consolidation, as the case may be, with the Department of State in a manner similar to that heretofore prescribed in this act in the case of the formation of a

business corporation. Advertisements shall appear at least three days prior to the day on which the articles of merger or articles of consolidation are presented to the Department of State, and shall set forth briefly:

(1) The name and the location of the registered office of each of the corporations intending to merge or consolidate.

(2) The name and the location of the proposed registered office of the surviving or new corporation.

(3) A statement that the articles of merger or consolidation are to be filed under the provisions of this act.

(4) The purpose or purposes of the surviving or new corporation.

(5) The time when the articles of merger or consolidation will be delivered to the Department of State.

Section 905. *Filing of Articles of Merger or Consolidation.* The articles of merger or articles of consolidation, as the case may be, and proof of the advertisement required by the preceding section, shall be delivered to the Department of State. If the Department of State finds that such articles conform to law, it shall forthwith, but not prior to the day specified in the advertisement required by the preceding section, endorse its approval thereon, and when all bonus, fees, taxes and charges have been paid, as required by law, shall file the articles and issue to the corporation, or its representative, a certificate of merger or a certificate of consolidation, as the case may be, to which shall be attached a copy of the approved articles.

Section 906. *Effective Date of Merger or Consolidation.* Upon the issuance of the certificate of merger or the certificate of consolidation by the Department of State, the merger or consolidation shall be effective. The certificate of merger or the certificate of consolidation shall be conclusive evidence of the performance of all conditions precedent to such consolidation or merger

and the creation or existence of a new or surviving corporation, except as against the Commonwealth. The merger or consolidation of one or more domestic corporations into a foreign corporation shall be effective according to the provisions of law of the jurisdiction in which such foreign corporations was formed, but not until articles of merger or articles of consolidation have been adopted and filed, as heretofore provided in this act.

Section 907. *Effect of Merger or Consolidation.* Upon the merger or consolidation becoming effective, the several corporations parties to the plan of merger or consolidation shall be a single corporation which, in the case of a merger, shall be that corporation designated in the plan of merger as the surviving corporation, and, in the case of a consolidation, shall be the new corporation provided for in the plan of consolidation. The separate existence of all corporations parties to the plan of merger or consolidation shall cease, except that of the surviving corporation, in the case of a merger. The surviving or new corporation, as the case may be, shall not thereby acquire authority to engage in any business or exercise any right which a corporation may not be formed under this act to engage in or exercise. All the property, real, personal, and mixed, of each of the corporations parties to the plan of merger or consolidation, and all debts due on whatever account to any of them, including subscriptions to shares and other choses in action belonging to any of them, shall be taken and deemed to be transferred to and vested in the surviving or new corporation, as the case may be, without further act or deed. The surviving or new corporation shall thenceforth be responsible for all the liabilities and obligations of each of the corporations so merged or consolidated, but the liabilities of the merging or consolidating corporations, or of their shareholders, directors, or officers, shall not be affected, nor shall the rights of the creditors thereof or of any persons dealing with such corporations, or any liens upon the property of such corporations, be impaired by such merger or consolidation, and any claim existing or action or

proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger or consolidation had not taken place, or the surviving or new corporation may be proceeded against or substituted in its place. In the case of a merger, the articles of incorporation of the surviving corporation shall be deemed to be amended to the extent, if any, that changes in its articles are stated in the articles of merger; and in the case of a consolidation, the statements set forth in the articles of consolidation, and which are required or permitted to be set forth in the articles of incorporation of corporations formed under this act, shall be deemed to be the articles of incorporation of the new corporation. The aggregate amount of the net assets of the merging or consolidating corporations which was available for the payment of dividends immediately prior to such merger or consolidation, to the extent that the value thereof is not transferred to stated capital by the issuance of shares or otherwise, shall continue to be available for the payment of dividends by such surviving or new corporation.

## APPENDIX E.

### Laws of Maryland, 1890, ch. 553.

It shall be lawful for any railroad company heretofore or hereafter incorporated under the laws of this State to consolidate with any other railroad company incorporated under the laws of this or any other State, or of the United States, whose railroad within or without this State shall connect with or form a continuous line with the railroad of the company so consolidating upon such terms as may be agreed upon; provided, however, that the agreement for such consolidation shall be submitted to the stockholders of the railroad company incorporated under the laws of this State at a special meeting called for considering the same, and shall be sanctioned by the holders of a majority of the stock of such company, and if sanctioned at such meeting by such holders of a majority of the stock, shall be filed in the office of the secretary of State of this State; and, provided, further, that such

agreement shall contain no provisions in conflict with the provisions of this article or which shall exempt such railroad so far as it lies in this State from the operation of the laws of this State, and nothing in this section shall be construed to authorize the consolidation of any railroad companies owning or operating, competing or parallel roads, or parallel lines of railroad which is hereby declared to be unlawful and expressly prohibited without the special consent of the general assembly being first obtained therefor.

# SUPREME COURT OF THE UNITED STATES.

Nos. 486 and 487.—October Term, 1938.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
vs.
Metropolitan Edison Company.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
vs.
Pennsylvania Water & Power Company.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 3, 1939.]

Mr. Justice Roberts delivered the opinion of the Court.

These cases present the question whether, under the Revenue Acts of 1926 and 1928,[1] a Pennsylvania corporation may deduct unamortized bond discount and expense in connection with redemption of the bonds of a subsidiary, all of whose assets it had previously acquired pursuant to local law. The court below answered this question in the affirmative.[2] By reason of a direct conflict of decision we granted the writ of certiorari.[3]

The respondent in No. 486 is a Pennsylvania corporation supplying electric light and power in that state and also operating, through subsidiaries, a system which serves communities in Pennsylvania and Maryland. It filed consolidated returns for itself and its subsidiaries for 1927 and 1928. During 1928 the company retired certain bonds of Pennsylvania corporations which were formerly subsidiaries whose obligations the taxpayer had assumed when it took over their assets by transfers effected pursuant to an Act of

[1] Revenue Act of 1926, Sections 200(d), 212(b), 232 and 234(a)(1)(2) and (f), 44 Stat. 9, 10, 23, 41-42; Revenue Act of 1928, Sections 23(a)(b) and (f), 42, 43, 48, 45 Stat. 791, 799-800, 805, 807.

[2] 98 F. (2d) 807, 812.

[3] See General Gas & Electric Corporation v. Commissioner of Internal Revenue, 98 F. (2d) 561, in which certiorari was also granted, decided *infra* p. ——.

the General Assembly of April 29, 1874, as amended and supple mented.[4] When these obligations were redeemed there existed with respect to them, unamortized discount and expense aggre gating $752,481.26, which the company in its return deducted fro gross income. The Commissioner ruled against the deduction an determined a deficiency. The Board of Tax Appeals sustaine the Commissioner.[5] The Circuit Court of Appeals reversed th Board holding that the transactions whereby the taxpayer acquire the assets and assumed the liabilities of its former subsidiaries, pu suant to the statute, constitued a merger, as a consequence of whic the subsidiaries ceased to exist by operation of law whereas th taxpayer continued to exist and became liable for the subsidiaries debts both under contract and by operation of law. The cour therefore, held that the unamortized discount and expense was de ductible in respect of the subsidiary's bonds.

In 1923 the respondent in No. 486 desired to erect a generatin plant for electric energy. Wishing to finance it by a separate bon issue the respondent organized Metropolitan Power Company, Pennsylvania corporation, as a wholly owned subsidiary. The tax payer purchased, guaranteed, and sold, at the same price it ha purchased, $3,250,000 of bonds of the subsidiary; purchased all o its stock and loaned it on open account approximately $3,000,00 The Power Company held no public franchises and, under a co tract with the taxpayer, sold all of its electricity to the latter at price sufficient to enable it merely to earn the costs of operatio and other charges, including depreciation, taxes, and interest. I 1927, pursuant to State authority, the Power Company sold all i assets subject to its liabilities to the taxpayer, a deficit from oper tions being charged against the taxpayer's surplus. At the tim of the transfer the taxpayer surrendered the stock of the Pow Company for cancellation and the latter became inactive and w dissolved in 1928. The taxpayer assumed liability for the outstan ing bonds of the Power Company payment of which it had original guaranteed and, during 1927, called them for redemption and r deemed them. At the time of the redemption there remained u amortized discount and expense incurred in issuing the bonds a

[4] Act of April 29, 1874, P. L. 73, Sec. 23, amended by Act of April 17, 187 P. L. 30, Sec. 5, and Act of June 2, 1915, P. L. 724, Sec. 1. Purdon's P Stats. Tit. 15, Sec. 595.

[5] 35 B. T. A. 1110.

gregating $308,097.90 which the taxpayer deducted from its gross income. The Commissioner ruled against the deduction and the Board of Tax Appeals sustained him.[6] The Court of Appeals reversed the Board, holding that, while the transaction was not consummated under the state statute it nevertheless was under state law a *de facto* merger and, the taxpayer was accordingly entitled to the deduction.

The respondent in No. 487 is a Pennsylvania corporation operating a hydro electric plant at Holtwood, Pennsylvania. In 1924 it desired to provide its customers with a more adequate supply by an auxiliary steam power plant. As its corporate powers did not permit steam generation of electricity it caused the incorporation of a Pennsylvania company, known as Holtwood Power Company, all of whose shares were purchased and owned by the respondent. With the proceeds of the sale of the Power Company's stock and those of a bond issue the steam plant was erected. This plant sold all its output to the taxpayer which agreed, in return, to pay the Power Company's costs and expenses and an allowance for depreciation, and to pay a sum to provide for amortization of debt, discount, and security issue expense, and the expenses attending the issue, registration and transfer of the capital stock and bonds, all interest on bonds and other indebtedness, and a sum sufficient to provide a net return of eight per cent. on the Power Company's stock. The steam plant was managed by the taxpayer's officers and employes without compensation and was operated as a department of the taxpayer. In 1927 the taxpayer surrendered certain corporate powers so as to be in a position to effect a merger or consolidation with its subsidiary under the Pennsylvania statutes.[7] Thereupon the Power Company conveyed all of its assets and franchises to the taxpayer pursuant to the Pennsylvania Act of 1874 as amended, the sole consideration being the delivery to the subsidiary of all its capital stock held by the taxpayer and the assumption by the taxpayer of the subsidiary's indebtedness. The subsidiary ceased to exist. In 1928 the taxpayer retired the bonds of its former subsidiary and charged off unamortized discount and expense in respect of them in the sum of $145,159.52 and, in its income tax return for that year, claimed a small deduction for

[6] 33 B. T. A. 1110.

[7] See York Haven Water & Power Co. v. Public Service Commission, 287 Pa. 241, 249; 134 Atl. 419, 421.

amortization for a portion of the year prior to the retirement, and a deduction of the balance of the sum above mentioned as of the date when the retirement took place. The Commissioner disallowed the deduction and determined a deficiency. The Board of Tax Appeals sustained the ruling.[8] The Circuit Court of Appeals reversed the Board.

The petitioner concedes that if there has been a true merger or consolidation whereby the identity of the corporation issuing the bonds continues in the successor and the latter becomes liable for the debts of the former by operation of law, the successor may deduct amortization of discount and expense in respect of bonds issued by its predecessor as well as unamortized discount and expense on any of such bonds retired prior to maturity.[9] The rule is not applicable upon a mere sale by one corporation of all its assets to another which assumes the liabilities of the former.[10]

The contention of the petitioner is that the transactions in issue fall within the latter category. The respondents, on the other hand, insist that, in the light of the applicable statute of Pennsylvania and the decisions of her courts, the transactions constituted mergers in the proper acceptation of that term. The question, then, is solely one respecting the law of Pennsylvania.

Until the complete revision of the corporation laws of the Commonwealth in 1933 there were but two statutes available to corporations seeking to merge or consolidate. The Act of April 29, 1874, Sec. 23, *supra*, so far as material, provides that any corporation, with the consent of its stockholders, may "sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid. . . ." The Act of May 3, 1909,[11] permits what

[8] 36 B. T. A. 467.

[9] American Gas & Electric Co. v. Commissioner, 85 F. (2d) 327; American Gas & Electric Co. v. United States, 17 F. Supp. 151; New York Cent. R. Co. v. Commissioner, 79 F. (2d) 247; Western Maryland Ry. Co. v. Commissioner, 33 F. (2d) 695; Illinois Power & Light Corp. v. Commissioner, 33 B. T. A. 1189; Connecticut Electric Service Co. v. Commissioner, 35 B. T. A. 444.

[10] Turner-Farber-Love Co. v. Helvering, 68 F. (2d) 416; American Gas & Electric Co. v. Commissioner, *supra*; American Gas & Electric Co. v. United States, *supra*.

[11] Purdon's Pa. Stats. Tit. 15, Sec. 421, etc.

terms a merger but what is in truth a consolidation to be effected by a joint agreement of two or more corporations approved by the stockholders setting forth the terms and conditions of the merger and consolidation and providing for the organization of a new corporation to which the franchises and property of the consolidating corporations are to be transferred. This act contemplates the issue of letters patent to the consolidated corporation, and the issue of new stock by it, in lieu of that of the old. The procedure under the Act of 1874 has repeatedly been referred to in the decisions of the Supreme Court of the Commonwealth as the "short form" and that under the Act of 1909 as the "long form" of merger.[12]

Inasmuch as the transfer of the franchises and assets is authorized by statute, it seems reasonably clear that the transferee is, as matter of law, liable for the obligation of the transferor. The cases indicate that this is so.[13] The petitioner argues and the Circuit Court of Appeals for the Second Circuit has held to the contrary, in reliance on *Merwine* v. *Mt. Pocono Light & Imp. Co.*, 304 Pa. 517, 156 Atl. 150. That court thought the case indicated that the liability, if any, of the transferee was not under the statute but was only that of a fraudulent transferee under 13 Eliz., chap. 5. Action for a tort had been brought against the transferor prior to a transfer under the Act of 1874. After the conveyance the defendant filed a suggestion that the property had been conveyed in proceedings under the Act, that the defendant had ceased to exist, and that the action should be abated. The plaintiff sought to substitute the transferee as defendant. The trial court denied substitution and abated the action. The Supreme Court held that the termination of corporate existence of the defendant under the Act of 1874 did not abate the action, but that if the plaintiff recovered a judgment she could "levy wherever defendant's assets liable for the judgment may be found", which seems to us to mean no more than that the assets after the conveyance remained subject to the transferor's liabilities. A transfer fully authorized by statute cannot be a fraudulent conveyance within the 13 Eliz.

We are of opinion that a transfer without valuable consideration, with the intent that the transferor shall, as the statute provides,

[12] See York Haven Water & Power Co. v. Public Service Commission, 287 Pa. 241, 246, 134 Atl. 419, 420; Buist's Estate, 297 Pa. 537, 541, 147 Atl. 606, 607; compare Stockley Penna. Corp. Laws 1933, pp. 39, 104; Penna. Utilities Co. v. Public Service Commission, 69 Pa. Super. Ct. 612.

[13] Berkovitz's Appeal, 319 Pa. 397, 407, 179 Atl. 746 at 751; Commonwealth v. Merchants National Bank, 323 Pa. 145, 155, 185 Atl. 823, 827.

cease to exist, made in accordance with the statute, has all the elements of a merger and comes within the principle that the corporate personality of the transferor is drowned in that of the transferee. It results that the continuing corporation may deduct unamortized bond discount and expense in respect of the obligations of the transferring affiliate.

A somewhat different question arises with respect to the transfer of assets of Metropolitan Power Company. It is admitted that this transfer was not made in accordance with the terms of the Act of 1874. No franchises were transferred because the Metropolitan Power Company held no public franchises of any kind. The transfer was merely of assets with the assumption of all the liabilities by the transferee. It is important to note, however, that amongst the liabilities assumed were bonds on which the parent company was already liable as guarantor. The court below has held, and we concur, that, under the law of Pennsylvania, the transfer in question constituted a *de facto* merger, even though the transfer did not comply with all the provisions of the Act of 1874,[14] and that, as matter of law, the taxpayer would be liable for the debts of the transferor.

*Judgments affirmed.*

A true copy.

Test:

*Clerk, Supreme Court, U. S.*

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[14] Commonwealth v. Merchants National Bank, *supra*, p. 152.